

**REPORT BY THE
AUDITOR GENERAL
OF CALIFORNIA**

**A REVIEW OF THE STATE'S CONTROLS
OVER ITS FINANCIAL OPERATIONS**

**A Review of the State's Controls
Over Its Financial Operations**

F-105, June 1992

**Office of the Auditor General
California**



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F-105

Honorable Robert J. Campbell, Chairman
Members, Joint Legislative Audit Committee
State Capitol, Room 2163
Sacramento, California 95814

Dear Mr. Chairman and Members:

The Office of the Auditor General presents its report concerning the results of our review of the State's control of its financial activities and its compliance with federal grant requirements and state regulations. This review was made as part of our examination of the State's general purpose financial statements. This report fully meets the requirements of the 1984 Single Audit Act set forth by the United States Government as a condition of receiving over \$16.3 billion in federal funds annually.

The State continues to lose millions of dollars each year because agencies do not promptly identify and collect amounts owed to the State, do not effectively control expenditures, and do not manage cash to maximize benefits to the State. In addition, the State continues to have numerous shortcomings in its financial reporting system that need to be resolved by the State's financial leadership. For example, the State does not have an accounting system that presents the financial condition of the State based on generally accepted accounting principles when reporting on the past execution of its budget. Instead, the state fiscal control departments report the financial condition of the State by using different accounting practices. This use of different accounting practices can cause the State's financial decision makers to be uncertain about the State's true financial condition.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Kurt Sjoberg".

KURT R. SJOBERG
Auditor General (acting)

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Summary

Status of Internal Controls	The State has many weaknesses in its accounting, auditing, and administrative control structure to correct. These weaknesses result in inaccurate financial statements, noncompliance with state and federal regulations, and the waste, loss, and misuse of state resources. For fiscal year 1990-91, 16 of the 20 agencies whose internal control structure we reviewed had weaknesses in the controls over their financial activities.
Actual and Potential Losses	In conducting our audit, we selected agencies that we determined to be the most material in relation to the major segments of the various funds in the general purpose financial statements. As a result, we audited 20 agencies, which represented approximately 61 percent of the State's revenues and approximately 60 percent of the State's spending. Other independent auditors audited an additional approximately 31 percent of the State's revenues and an additional approximately 22 percent of the State's spending. We also audited the financial operations of 7 other agencies for fiscal year 1989-90.

Actual and Potential Losses

The State did not promptly collect money owed to it nor did it promptly pay invoices. As a result, the State may have lost approximately \$1.1 million in foregone interest and discounts. Because the State does not always follow established collection procedures, it may also have difficulty collecting some of the approximately \$188.5 million that has been owed to it for extended periods. Further, the State may have lost approximately \$31.1 million in revenues and may have incurred unnecessary

expenditures of approximately \$464,000. These amounts do not represent all the potential or actual losses the State may have incurred because we identified these losses by reviewing a sample of transactions. Appendix A presents a schedule, by state agency, of actual and potential losses identified during our review of the State's financial activities.

Many of the weaknesses in internal controls that we observed did not result in losses. However, if state agencies do not correct the weaknesses and provide proper accounting, auditing, and administrative controls, the opportunity exists for the State to suffer more serious losses in the future.

**Statewide
Concerns**

Although the State corrected several of the weaknesses that we identified in recent years, it continues to have numerous shortcomings in its internal control and financial reporting systems, which need to be addressed by its financial leadership. Weaknesses that we reported in recent years that the State corrected, included the presentation for the first time in the State's financial statements for fiscal year 1990-91 of the general fixed asset account group. In addition, the State added regulations to the State Administrative Manual that restrict the use of fiscal agents by state departments. However, the State did not correct several weaknesses related to its accounting practices, financial reporting, and internal controls. For example, the State Controller's Office and the Department of Finance use different accounting practices. This use of different accounting practices can cause the State's financial decision makers to be uncertain about the State's true financial condition. Further, the State must make numerous adjustments to its financial statements to prepare them in accordance with generally accepted accounting principles (GAAP) so that they may be comparable to the financial statements of other states and acceptable to the investment community and the federal government. GAAP is the preferred method of accounting because it is a nationally recognized set of accounting principles that improves accountability, recognizing costs when they occur, not when they are paid for.

Furthermore, the State currently does not recognize tax overpayments and some costs when reporting on the past execution of the budget. For fiscal year 1990-91, the State recognized as revenues approximately \$1.13 billion in tax overpayments that will probably have to be refunded or applied to future years. Moreover, the State did not recognize costs that totaled approximately \$1.15 billion in fiscal year 1990-91. The \$1.15 billion consisted of more than \$712 million in Medi-Cal services provided but not yet paid for, approximately \$194 million for earned pension costs, approximately \$98 million for the cost of earned vacation for certain state faculty, approximately \$75 million in costs the State owed exceeding available appropriations, and approximately \$72 million in costs for lawsuit claims and federal audit exceptions. Beginning in fiscal year 1991-92, the State plans to change its accounting for Medi-Cal expenditures to a method that is in accordance with GAAP.

We noted other weaknesses that we have reported in recent years. For example, the State does not produce audited financial statements within six months of the end of the fiscal year, and it does not include in its audited financial statements the combining statements that provide the financial statements of each of the funds within the fund types. As a result of these two weaknesses, as we have reported for the last five years, the State does not qualify for the Certificate of Achievement for Excellence in Financial Reporting. The State also continues to spend unnecessary additional time and effort in preparing the financial statement disclosures required by GAAP for the State's lease commitments because the State does not have a central record of lease commitments that contains all the necessary information. Further, the State's method of accounting for federal assistance does not yet provide sufficient information on expenditures of federal money for each federal program.

Weaknesses at State Agencies

Many of the agencies we audited had weaknesses in internal controls over financial reporting, revenue, and expenditure activities. We also noted immaterial instances of noncompliance with state and federal regulations at several agencies. Some deficiencies in internal controls were common throughout the State.

Weak Controls Over Financial Activities

Twelve of the agencies we audited had weaknesses in their internal controls over financial reporting. Problems we found included incorrect or nonexistent reconciliations, inappropriate accounting practices, and inadequate accounting for property and inventory. In some cases, these problems resulted in inaccurate financial statements. For example, the Department of General Services (department) overstated its due to local governments account balances at June 30, 1991, by approximately \$15.7 million. This overstatement occurred because, for some school building projects, the department did not record in its general ledger certain grant awards and did not record all grant payments that had been cancelled. In addition, the department did not detect the overstatement because it does not reconcile its subsidiary project cards with its general ledger account balances.

Fourteen of the agencies we audited had weaknesses in internal controls over revenue activities. Problems we found included failure to bill for and collect receivables, failure to follow proper procedures for recognizing revenue earned, and failure to deposit receipts promptly. These problems resulted in receivables that may be difficult to collect, in inaccurate financial statements, and in the loss of interest revenue. For example, because the Department of Health Services delayed requesting federal reimbursements for a federal grant program, it lost approximately \$429,000 in potential interest income.

Problems involving expenditure activities existed at 14 of the agencies we audited. The problems we found included insufficient control over payroll, insufficient monitoring and control over revolving fund activities, improper separation of duties, and other weaknesses in control over disbursements. For example, the Stephen P. Teale Data Center does not have adequate separation of duties over its expenditure activities. Specifically, the person who signs checks also authorizes disbursements, prepares and approves all journal entries, and maintains the general ledger. He also prepares the bank reconciliations when the employee who usually performs this task is unable to do so. The same person prepares journal entries to record equipment, posts these entries to the

general ledger, and reconciles the property records. Failure to separate accounting duties adequately can result in errors, irregularities, or illegal acts that may go undetected for extended periods. Weaknesses in controls over expenditures can result in the loss of state funds.

Lack of Compliance With State Regulations

The State complied in all material respects with its regulations that could materially affect its financial statements. However, a few agencies had certain immaterial instances of noncompliance in remitting monies to the State Treasurer's Office, receiving approval of contracts before work began, and submitting financial reports to the State Controller's Office. Although these weaknesses did not have a material effect on the financial statements, the weaknesses could result in incorrect accounting for cash balances and in the State's interests being put at risk because of improper contracting.

Lack of Compliance With Federal Regulations

In fiscal year 1990-91, the State received approximately \$16.3 billion in federal grants. At many state agencies, we noted immaterial instances of noncompliance with the federal regulations for administering these federal grants. Adherence to these regulations is a condition of continued federal funding. The State did not fully comply with all federal regulations in 35 of the 43 grants we reviewed.

These 43 grants represent approximately 96 percent of all federal money the State received for fiscal year 1990-91, excluding that received by the University of California. Our review showed that agencies failed to adhere to requirements for reporting, for supporting expenditures, for cash management, and for program monitoring and auditing. The federal government could penalize the State because of its failure to comply with federal regulations.

Introduction

As part of our examination of the general purpose financial statements of the State of California for the fiscal year ended June 30, 1991, we studied and evaluated the State's internal control structure. The purpose of our study of this structure was to determine the audit procedures and the extent of testing necessary for (1) expressing an opinion on the State's general purpose financial statements, (2) determining compliance with federal grant requirements, laws, and regulations, and (3) determining compliance with state laws and regulations that could materially affect the general purpose financial statements. In conducting our audit, we reviewed and evaluated fiscal controls at 20 of the 306 state agencies included in the general purpose financial statements.

Amounts that we audited at these agencies represented approximately 61 percent of the State's revenues and approximately 60 percent of the State's spending. Further, other independent auditors audited an additional approximately 31 percent of the State's revenues and an additional approximately 22 percent of the State's spending. In addition to this audit coverage of the State's revenues and spending, we increased our coverage with centralized testing, which we performed by selecting for review a cross section of items from the State as a whole. For example, we selected a sample of payroll warrants the State processed through its payroll system, and we selected a sample of warrants other than payroll warrants that the State processed through its claims payments system. We also reviewed electronic data processing activities at selected state agencies that have significant data processing operations.

We audited the financial operations of seven operating departments for fiscal year 1989-90. We issued the audit results of these seven operating departments after we issued the State of California Comprehensive Financial and Compliance Audit Report for the Year Ended June 30, 1990. We include the results of these audits in this report.

We reviewed 20 agencies' compliance with state laws and regulations that materially affect the State's financial statements. Compliance with these laws and regulations helps to ensure that the State maintains sufficient control over the budgeting, investing, collecting, and disbursing of state money and that it maintains sufficient control over reporting the results of state financial activities.

Finally, except for the Pell Grant Program, which is reviewed by other independent auditors, we reviewed the State's compliance with federal regulations for all federal grants exceeding \$20 million. In all, we reviewed 43 of the 289 federal grants the State administers. These 43 grants represent approximately 96 percent of the federal funds the State received in fiscal year 1990-91, excluding those funds the University of California received. In addition, as part of our examination of the State's financial statements, we selected transactions related to other federal programs and reviewed these transactions for compliance with applicable federal regulations.

The specific scope of our audit is stated in the following reports that the federal Office of Management and Budget, Circular A-128, requires the State to issue each year:

- The report on the internal control structure used in preparing the general purpose financial statements and in administering federal assistance programs (begins on page 33);
- The report on weaknesses and instances of noncompliance at state agencies (begins on page 39);

- The report on federal assistance programs, including required reports on (1) compliance with laws and regulations related to major and nonmajor federal programs and (2) the resolution of prior year findings related to federal programs (begins on page 275);
- The report on the accuracy of the supplementary schedule of federal assistance (begins on page 281); and
- The report on compliance with state laws and regulations (begins on page 331).

Between July 1, 1990, and December 31, 1991, the Office of the Auditor General issued 61 audit reports, many of which discussed improvements needed in the State's operations. These reports, listed in Appendix B, are available to the public.

Statewide Concerns

Summary Although the State corrected several of the weaknesses that we identified in recent years, the State continues to have numerous shortcomings in its internal control and financial reporting systems that need to be addressed by its financial leadership. Weaknesses we reported in recent years that the State corrected included the presentation for the first time in the State's financial statements for fiscal year 1990-91 of the general fixed asset account group. In addition, the State added regulations to the State Administrative Manual that restrict the use of fiscal agents by state departments. However, the State did not correct several weaknesses related to its accounting practices, financial reporting, and internal controls. For example, partly because it does not use nationally recognized accounting principles to report on the past execution of the State's budget, the State has inconsistently reported its financial condition. The State also does not provide sufficient instructions to make an efficient and reliable conversion of the financial reports from their presentation in accordance with the State's statutory and regulatory requirements (budgetary basis) to a presentation in accordance with generally accepted accounting principles (GAAP). Moreover, the State does not ensure that the charges of internal service funds to federal programs are in compliance with federal regulations. Furthermore, the State does not yet qualify for the Government Finance Officers Association's Certificate of Achievement for Excellence in Financial Reporting because it does not produce audited financial statements within six months of the end of the fiscal year and because it does not include the combining statements that provide the financial statements of each fund within the fund types. In addition, the State does not have a central record of state leases that contains all the information required by GAAP, and it

does not have sufficient control over contracts that are not subject to approval by the Department of General Services. Further, the State's method of accounting for federal assistance does not provide sufficient information on expenditures of federal money for each federal program. Finally, the State does not require the District Agricultural Associations to submit financial reports to be included in the State's financial statements, and it does not require other agencies to submit certain reconciliations and reports.

**Inconsistent
Financial
Reporting**

The State Controller's Office and the Department of Finance each report on the State's financial condition using different accounting practices. This use of different accounting practices can cause the State's financial decision makers to be uncertain about the State's true financial condition. Further, the State must make numerous adjustments to its financial statements to prepare them in accordance with GAAP so that they may be comparable to the financial statements of other states and acceptable to the investment community and the federal government. GAAP is the preferred method of accounting because it is a nationally recognized set of accounting principles that improves accountability, recognizing costs when they occur, not when they are paid.

Further, although the State accounts for General Fund encumbrances in accordance with GAAP, it still does not account for other expenses and revenues in accordance with GAAP when reporting on the past execution of its budget. The State does not recognize some expenses, including the cost of Medi-Cal services provided but not yet paid for and the cost of earned vacation for certain state faculty. Also, the State has historically recognized some events as expenses even though no cost has been incurred. For example, the State reports loans from its General Fund to other funds as expenses rather than recognizing that money was lent to another fund and will be returned to the General Fund. Additionally, the State recognizes as revenue tax overpayments that will probably have to be refunded or applied to future years. Beginning in fiscal year 1991-92, the State plans to change its accounting for Medi-Cal expenditures to a method that is in accordance with GAAP.

The following schedule displays the adjustments that were needed to present the fund balance of the State's General Fund (as reported by the State Controller's Office) in accordance with GAAP (in thousands):

Adjustments Due to Unreported Expenses:	
Medi-Cal Services Provided	\$ 712,151
Earned Pension Benefits	194,483
Earned Vacation Leave	98,095
Costs Owed in Excess of Available Appropriations	75,444
Lawsuit Claims Owed	59,448
Federal Audit Exceptions Owed	11,814
Total Adjustments Due to Unreported Expenses	1,151,435
Adjustments Due to Tax Overpayments Owed to Taxpayers	1,127,953
Adjustments Due to Loans That Will Be Repaid to the General Fund	(102,452)
Total Adjustments	\$2,176,936

Adjustments were also necessary to present the fund balances of the State's other fund types (as reported by the State Controller's Office) in accordance with GAAP. For example, the State recognizes as an addition to fund balance its authorized but unissued bonds. Under GAAP, the proceeds from bonds should not be recognized until the sale occurs. In addition, the State reports as encumbrances grants to local agencies when the commitments are made. Under GAAP, the grants are not reported as encumbrances because the local agencies, not the State, receive the related goods or services. Instead, under GAAP, they are reported as commitments in the notes to the financial statements.

Problems With the State's Conversion to GAAP

The California Government Code, Section 12460, requires the State Controller's Office to prepare an annual report containing a statement of the funds of the State, its revenues, and the public expenditures of the preceding fiscal year on the same basis as that of the governor's budget and the budget act (budgetary basis). This

section also requires that the format of the budgetary report be prepared as closely as possible in accordance with GAAP. The State Controller's Office currently issues the Annual Report of the State of California in conformance with the State's budgetary basis of accounting, which is not in accordance with GAAP. The State Controller's Office must then convert the State's financial statements to GAAP to prepare the State's general purpose financial statements. The Department of Finance has not provided agencies with sufficient instructions in the State Administrative Manual to make this conversion from the budgetary basis to GAAP efficient and reliable. As a result, the financial information that agencies provide to the State Controller's Office is frequently insufficient for the State Controller's Office to prepare the State's general purpose financial statements in accordance with GAAP. For example, the Franchise Tax Board and the Board of Equalization do not provide information to the State Controller's Office on tax overpayments that are required to be recognized as liabilities in accordance with GAAP.

In addition, some of the financial information required under GAAP is more extensive than the information provided by the budgetary basis of accounting. As a result, the State must develop additional information for proprietary funds, lease commitments, and the market value of the State's investments in securities to create its general purpose financial statements. We have reported a similar weakness in our audits for the last eight years.

The State is in the process of converting from the budgetary basis to GAAP in certain areas. The Department of Finance has rewritten some sections of the State Administrative Manual covering proprietary funds to bring them into conformance with GAAP. In addition, in the governor's budget, the Department of Finance treats the State's General Fund encumbrances as a reservation of fund balance rather than as expenditures and has extended this treatment to the year-end financial statements. This treatment is consistent with GAAP in that encumbrances are obligations for which goods and services have not been received, and they should not be shown as expenditures. Further, the State's Fund Manual has been rewritten to bring it into conformance with

GAAP. Until the State incorporates all of the necessary generally accepted accounting principles into state law, the State must continue spending time and money to convert its financial records from the budgetary basis to GAAP so that they are comparable with those of other governmental entities and, therefore, acceptable to the investment community and the federal government under the single audit act.

Some Internal Service Funds Do Not Always Comply With Federal Regulations

The State has a possible liability to the federal government estimated to be as much as \$24 million for profits it has accumulated in its internal service funds between July 1, 1984, and June 30, 1991. This condition exists because the Department of Finance has not ensured that charges to federal programs are in compliance with federal regulations. The State's internal service funds provide goods and services to state agencies and charge them for these goods and services. In turn, the state agencies have passed these charges on to federal programs that the State administers. When the charges of internal service funds exceed the costs for providing services, the State accumulates profits in its internal service funds.

In 1984, the federal Department of Health and Human Services (DHHS) audited the State's rate-setting methods for internal service funds. As a result, the State was required to refund to the federal government approximately \$14.9 million of the profits accumulated in its internal service funds. This amount represented the federal share of profits accumulated by five of the State's internal service funds from July 1, 1969, to June 30, 1984. Because the State's internal service funds continue to accumulate profits, the State may be liable to the federal government for the portion of the additional surplus accumulated between July 1, 1984, and June 30, 1991, that represents charges to federal programs.

Using procedures similar to those of the Department of Finance and using the same percentages that were used to determine the federal share of the State's profit in the 1984 audit, we estimate

that, under current federal regulations, the State may owe the federal government as much as \$24 million. This amount is the federal share of profits accumulated by four of the five internal service funds mentioned above from July 1, 1984, to June 30, 1991, less audit adjustments and undercharges to federal programs of approximately \$21,000 for the other fund. Since the federal government and the State's executive branch are ultimately responsible for negotiating any final settlement, we did not attempt to determine whether the percentage that the federal government accepted to determine the federal share of the State's accumulated profits in the 1984 audit is still acceptable for the period from July 1, 1984, to June 30, 1991. In addition, an October 1988 amendment to the federal Office of Management and Budget's (OMB), Circular A-87, *Cost Principles for State and Local Governments*, which has been proposed but not yet approved, would allow state agencies a reasonable working capital reserve of 60 days' cash expenditures. If approved, this amendment may reduce the liability for two of the funds to approximately \$12.1 million. We reported a similar weakness in our audits for the last two years.

While the State's internal service funds may be in compliance with state laws that allow them to accumulate surpluses up to certain limits, they may be in noncompliance with the current provisions of the OMB's, Circular A-87. The OMB's, Circular A-87 does not allow the State to charge federal programs for amounts that exceed costs. The California Government Code, Section 13070, provides the Department of Finance with general powers of supervision over all matters concerning the financial and business policies of the State. Therefore, it is the responsibility of the Department of Finance to provide adequate guidelines to the agencies that administer internal service funds to ensure that charges to federal programs are in compliance with federal regulations.

**Delays in
Producing
Audited
Financial
Statements**

As we have reported for the last six years, the State has been unable to produce the necessary financial reports in time to issue audited financial statements within six months of the end of the fiscal year, a time requirement established in 1980 by the Government Finance Officers Association. While major corporations such as IBM, General Motors, and Pacific Gas and Electric are required to issue their audited annual financial reports within 90 days after the close of the fiscal year, the State has 180 days. However, the State has repeatedly taken longer than 200 days to issue its audited financial report. The financial statements for fiscal year 1990-91 were issued on March 31, 1992.

To address this concern, the Office of the Auditor General contracted with Price Waterhouse to evaluate the State's financial reporting system. Price Waterhouse identified shortcomings throughout the State's financial reporting system and made recommendations for correcting them. In response to Price Waterhouse's recommendations, a committee consisting of representatives from various state control agencies has been formed to improve the State's reporting system. The committee has initiated a pilot project to make financial reporting more accurate and prompt. The project involves the development of automated reconciliations of agency records with records of the State Controller's Office, a proposed reduction in the number of reports required from agencies, and a preliminary plan for electronic reporting of year-end financial data to the State Controller's Office.

**Lack of
Combining
Statements
by Fund Type**

As we have reported for the last two years, the State has not included combining statements by fund type in its audited financial statements. These combining statements provide financial statements of each of the individual funds within the fund types shown in the general purpose financial statements. Section 2200.101 of the Governmental Accounting and Financial Reporting Standards, issued by the Governmental Accounting Standards Board, states that every governmental unit should prepare a Comprehensive Annual Financial Report, which includes general purpose financial statements by fund type and account

group as well as the combining statements by fund type and individual fund statements.

The State has not prepared combining statements by fund type in accordance with these guidelines issued by the Governmental Accounting Standards Board. The State's system accounts for its funds in a manner that, in some cases, is not in full agreement with GAAP. For example, the State accounts for some of its funds as Trust and Agency and Capital Project Fund Types on the budgetary basis, but reports the same funds in the Special Revenue Fund Type in the general purpose financial statements.

Ineligibility for Certificate of Achievement

The State does not yet qualify for the Certificate of Achievement for Excellence in Financial Reporting. The Certificate of Achievement Program of the Government Finance Officers Association encourages and recognizes excellence in financial reporting by governments. The State does not qualify for the certificate primarily for two reasons: it does not produce audited financial statements within six months of the end of the fiscal year, and its audited financial statements do not include combining statements by fund type. We discussed these weaknesses in the preceding sections. We have reported a similar weakness in our audits for the last five years.

Insufficient Reporting of Leasing Information

As we reported in the last four fiscal years, the State continues to spend unnecessary additional time and effort in preparing the financial statement disclosures required by GAAP for the State's lease commitments because the State does not have a central record of lease commitments that contains all the necessary information. The State's lease commitments totaled approximately \$4.3 billion in fiscal year 1990-91. GAAP requires the State, when it leases space or equipment from outside vendors, to disclose commitments for future minimum lease and rental payments in a summary that separates these future payments by fiscal year. Although the Department of General Services maintains space and equipment

lease records for many lease commitments, it established these records for its internal management purposes and did not intend the records to be a complete listing of the State's leases that would meet GAAP requirements. Thus, the records do not provide all the necessary information.

For example, the records maintained by the Department of General Services disclose only the current year payment for each lease and do not indicate how the payment will change in future years. The records also do not separate future minimum lease and rental payments by fiscal year, and the records do not include information on certain leases for which the Department of General Services does not have oversight responsibility. For example, because the Department of General Services is not required to approve the California State Lottery Commission's leases, the department's records do not include more than \$3 million in commitments that the California State Lottery Commission has entered into for its leasing of space.

Governmental accounting and reporting standards require that governmental accounting systems allow the fair presentation and full disclosure of the governmental entity's financial position and results of financial operations in accordance with GAAP. In addition, the California Government Code, Section 12460, requires the State Controller's Office to present the State's financial position in a format that is as close as possible to GAAP.

**Inadequate
Control Over
Some
Contracts**

As we reported in the last two fiscal years, grants and certain contracts and interagency agreements are not routed through the Department of General Services. The State Administrative Manual, Section 1203, mandates that only those contracts requiring the Department of General Services' approval be transmitted to the Department of General Services. Grants of state funds are not subject to approval by the Department of General Services. Because some agencies consider certain contracts to be grants, they conclude that these contracts also do not require the approval of the Department of General Services. As a result, grants of state funds

and some contracts and interagency agreements go directly from the originating agency to the State Controller's Office. Thus, the State Controller's Office does not have assurance that these grants, contracts, and interagency agreements are valid. This weakness would be minimized by having the Department of General Services act as a clearinghouse for all grants, contracts, and interagency agreements. As part of the clearinghouse function, the Department of General Services should establish a statewide vendor list that would contain all entities with which the State contracts. The State Controller's Office would then have more assurance that the grants, contracts, and interagency agreements it receives from the Department of General Services are valid.

In addition, certain contracts between the State and local governments for grants are not being approved by the Department of General Services. Various state agencies believe these contracts are not subject to the Department of General Services' approval. Certain departments have received and relied on legal opinions from the Attorney General's Office and their own departmental legal counsel in determining whether these types of contracts are subject to the Department of General Services' approval. Based on its interpretation of the present rules, the Attorney General's Office has determined that contracts for grants of federal funds and contracts for grants of state funds are not required to be approved by the Department of General Services.

Whether or not a contract with a local government involves a grant of state or federal funds, we believe there is a weakness in the State's control over these types of contracts when the Department of General Services does not approve them. Therefore, we recommend that the Department of Finance clarify the sections of the State Administrative Manual regarding contract approval requirements. Specifically, contracts for grants of either state or federal funds to local governments should be subject to the same approval requirements established in the State Administrative Manual for other types of contracts.

**Failure To
Account for
Expenditures of
Federal Money
by Each Federal
Program**

The State's method of accounting for federal assistance does not provide sufficient information on expenditures of federal moneys because it does not record its expenditures by federal program. We reported a similar weakness for the last five fiscal years. As a result, the State is not able to present a schedule of federal assistance that shows total expenditures for each federal assistance program; therefore, the State is not in compliance with the OMB's, Circular A-128. The schedule of federal assistance that we present, beginning on page 285, shows total receipts rather than expenditures.

The OMB's, Circular A-128, requires the State to submit an audit report on a schedule of federal assistance that shows the total expenditures for each federal assistance program. The California Government Code, Section 13300, assigns the Department of Finance the responsibility for establishing and supervising a complete accounting system to ensure that all revenues, expenditures, receipts, disbursements, resources, obligations, and property of the State are properly accounted for and reported.

**Improper
Omissions
From the State
Reporting
Process**

As we have reported for the last three fiscal years, District Agricultural Associations, which are organized to hold fairs and expositions, are not treated as part of the state reporting entity. To determine whether the District Agricultural Associations should be treated as such, we requested a legal opinion from the Legislative Counsel. The Legislative Counsel found that the District Agricultural Associations are state agencies and that money they spend is state money. Further, funds for support of the District Agricultural Associations are appropriated in the State's annual budget. For these reasons, the Legislative Counsel concluded that the State Controller's Office is required to include the financial information of the District Agricultural Associations in the State's general purpose financial statements. Currently, this financial information is not included, and as a result, the State's general purpose financial statements are incomplete.

Failure To Require Agencies To Submit Reconciliations For approximately 223 funds numbered 500 to 699 and 800 to 999, the State Administrative Manual, Section 7951, does not require agencies to prepare Report 15, Reconciliation of Agency Accounts With Transactions Per State Controller. As a result, the State Controller's Office does not have evidence that agencies have reconciled financial information that appears in the general purpose financial statements with records of the State Controller's Office. We have reported a similar weakness in our audits for the last five fiscal years.

The State Administrative Manual, Section 7900, discusses the importance of making regular reconciliations. Reconciliations represent an important element of internal control because they provide a high level of confidence that transactions have been processed properly and that the financial records are complete. The reconciliation with the records of the State Controller's Office is an important step in ensuring the accuracy of the agencies' financial statements.

Failure To Require Agencies To Prepare a Report of Accruals The State Administrative Manual, Section 7951, does not require agencies to prepare Report 1, Report of Accruals to the Controller's Accounts, for funds numbered 500 to 699 and 800 to 999. Included among these funds are more than 72 that had budget appropriations for fiscal year 1990-91. As a result of not preparing this report, information needed to distinguish encumbrances from accounts payable and to present financial information in accordance with GAAP is not available for all funds. We have reported a similar weakness in our audits for the last five fiscal years.

The California Government Code, Section 12460, requires the State Controller's Office to present the State's financial position in a format that is as close as possible to GAAP. State agencies submit financial reports to the State Controller's Office, which then issues the financial report presenting the State's financial position. In addition, Section 1100.101 of the Governmental Accounting and Financial Reporting Standards, issued by the Governmental Accounting Standards Board, requires that agencies' accounting systems make it possible to present fairly the agencies' financial position and results of operations in accordance with GAAP.

Summary of Audit Results by Area of Government

Summary The State of California continues to face unnecessary costs and the reduced efficiency and effectiveness of its operations because of weaknesses in its internal control structure. Although the State has corrected some of the problems we observed in previous years, the State can still significantly improve its accounting and administrative control structure.

Table 1, which begins on page 18, shows the distribution by state agency of weaknesses in control over financial activities and weaknesses in compliance with state and federal regulations. A more detailed table for weaknesses in federal compliance begins on page 311. The page number column in Table 1 provides the location of our management letter for the indicated state agency. The numbers in the other columns provide the frequency of occurrences of each weakness as presented in the agencies' management letters.

Beginning on page 22, we present a summary of the most significant findings by area of government. At the beginning of each section, we present additional information regarding audit work performed.

Table 1

Weaknesses in Internal Control Structure

Agency	Page Number	Number of Occurrences ^a			
		Financial Reporting Activities	Revenue Activities	Expenditure Activities	Electronic Data Processing Activities
BUSINESS, TRANSPORTATION AND HOUSING					
Motor Vehicles, Department of	59	2	1	1	1
Stephen P. Teale Data Center	66	4	2	2	2
Transportation, Department of	80	1	4	3	5
EDUCATION					
California Community Colleges, Chancellor's Office	91	2	3	3	1
California School for the Deaf, Northern California ^c	101	1	2	3	
California State University	106	1	1	4	
California Student Aid Commission	110				10
Education, California Department of	121				13
					3

Footnotes are presented on page 21

Agency	Page Number	Financial Reporting Activities	Number of Occurrences ^a				
			Revenue Activities	Expenditure Activities	Electronic Data Processing Activities	Compliance With Federal Regulations ^b	Compliance With State Regulations ^b
GENERAL GOVERNMENT							
Criminal Justice Planning, Office of	135				5		
Economic Opportunity, Department of	141		1			2	
Finance, Department of	144				3	1	
Personnel Administration, Department of	151	1					
HEALTH AND WELFARE							
Alcohol and Drug Programs, Department of	157				7		
Employment Development Department	164		1	2		5	
Health and Welfare Agency Data Center	171					1	
Health Services, Department of	173		5	5		11	2
Mental Health, Department of	192			2		3	1
Social Services, Department of	200	1			1	7	

Footnotes are presented on page 21

Agency	Page Number	Financial Reporting Activities	Revenue Activities	Number of Occurrences ^a			
				Expenditure Activities	Electronic Data Processing Activities	Compliance With Federal Regulations ^b	Compliance With State Regulations
LEGISLATIVE, JUDICIAL, AND EXECUTIVE							
Emergency Services, Office of Equalization, Board of	211		2			2	
Secretary of the Health and Welfare Agency, Office of the	214		2			2	
State Treasurer's Office	221					2	
	223		3				
RESOURCES							
Water Resources, Department of	229	1		3			
State Water Resources Control Board	233					1	
STATE AND CONSUMER SERVICES							
Consumer Affairs, Department of; Architectural Examiners, Board of; Cosmetology, Board of; and Electronic and Appliance Repair, Bureau of ^c	237	3	3	3			
Fair Employment and Housing, Department of	243					1	
Franchise Tax Board	244	1			3		

Footnotes are presented on page 21

Agency	Page Number	Number of Occurrences ^a				
		Financial Reporting Activities	Revenue Activities	Expenditure Activities	Data Processing Activities	Compliance With Federal Regulations
STATE AND CONSUMER SERVICES (Continued)						
General Services, Department of	250	4		4		1
Public Employees' Retirement System	266				1	2
YOUTH AND ADULT CORRECTIONAL						
Corrections, Board of	269		1			
Corrections, Department of	271			1		
Youth Authority, Department of the	273				1	

^aThis is the number of occurrences of each weakness as presented in the state agencies' management letters.

^bThe table on page 311 provides more detail regarding the weaknesses in compliance with federal regulations.

^cWe audited the financial operations of these agencies for fiscal year 1989-90; however, we issued the audit results after we issued the State of California Comprehensive Financial and Compliance Audit Report Year Ended June 30, 1990.

**Business,
Transportation
and Housing**

In fiscal year 1990-91, the State spent more than \$5.6 billion, approximately 6 percent of the State's expenditures, on programs in the Business, Transportation and Housing Agency. The agency oversees the operations of 20 departments and other budgeted activities. In addition to our centralized testing and the audits performed by other independent auditors, our financial and compliance audit focused on five departments: the Department of Housing and Community Development, the Department of Insurance, the Department of Motor Vehicles, the Stephen P. Teale Data Center, and the Department of Transportation. We audited two federal programs with receipts of approximately \$1.5 billion for compliance with federal regulations. Since July 1990, we also have issued seven special topic reports that include issues relating to Business, Transportation and Housing programs. These special topic reports required our office to review selected operations of three additional entities: the Department of Alcoholic Beverage Control, the California Housing Finance Agency, and the Office of Traffic Safety. (Appendix B lists the reports that the Office of the Auditor General issued from July 1, 1990, to December 31, 1991.)

We reported weaknesses for three departments within the Business, Transportation and Housing Agency. In the following section, we discuss the most significant weaknesses we reported.

Department of Motor Vehicles

The Department of Motor Vehicles (department) does not have sufficient control over the collection of dishonored checks. As of June 30, 1991, the department had approximately \$13.4 million in checks that banks had not honored. Two of the units within the department responsible for collecting dishonored checks did not notify the revenue collection unit when they received payment on these checks. As a result, the collection was treated as a revenue rather than as a collection of a dishonored check. In addition, none of the units notified the revenue collection unit when they determined that certain checks were not collectible. Consequently, these uncollectible checks were not included in other programs such as the Franchise Tax Board's Offset program, which is designed to offset the amount owed to a state agency by the person

who paid the dishonored check by reducing the individual's tax refund for the amount of the check. Also, none of the units ensured that three collection letters were sent to the person who paid the dishonored check. Finally, a unit routinely waives penalties that are assessed against uninsured motorists involved in an accident when the penalty is paid with a dishonored check. Thus, the department is not only waiving this penalty, it is also forfeiting an unspecified amount of revenue it could be collecting.

Stephen P. Teale Data Center

The Stephen P. Teale Data Center (data center) does not foster a strong internal control environment. Specifically, we noted that the data center's management has not provided adequate direction to correct internal control problems within its accounting unit. As a result, the data center has not corrected many of the deficiencies we found in our previous financial audits. For example, the data center has weaknesses in its control over and accounting for equipment and intangible assets that we have reported in recent years. For example, the data center has no records to show that it has taken a physical inventory of its equipment within the last three fiscal years. Further, the data center equipment identification numbers listed in its property records did not always agree with the identification number assigned to the equipment. The data center's failure to maintain sufficient controls over its equipment prevents prompt detection of errors and exposes state property to increased risk of loss.

The data center's weaknesses in accounting for equipment and intangible assets resulted in incorrect account balances. Specifically, the data center did not remove from its equipment balance at June 30, 1991, eight items of equipment valued at approximately \$1.2 million that it had sold or had removed from service before the end of fiscal year 1989-90. The data center also recorded the costs of the software it purchased as an operating expense rather than as an intangible asset. State regulations require state agencies to record certain software costs as intangible assets and to allocate to expenses systematically the cost of the software over its useful life. Because the data center recorded its software purchases as an expense, it overstated its operating expenses for

fiscal year 1990-91 by approximately \$496,000. In addition, the data center had not recorded intangible assets of approximately \$5 million as of June 30, 1991.

Further, the data center does not have adequate separation of duties in its accounting section. Specifically, employees of the data center's accounting section perform incompatible duties related to the disbursement of funds, reconciliation of bank accounts, accounting for equipment, receipt and deposit of funds, and purchase of merchandise. Failure to separate incompatible accounting duties adequately can result in errors, irregularities, or illegal acts that may go undetected.

Education

In fiscal year 1990-91, the State spent more than \$37.7 billion, approximately 43 percent of the State's expenditures, on education programs. This area of government consists of 17 departments and other budgeted activities. In addition to our centralized testing and the audits performed by other independent auditors, our financial and compliance audit focused on five departments: the California School for the Deaf, Northern California; the California Community Colleges, Chancellor's Office; the California State University; the California Student Aid Commission; and the California Department of Education. We audited 13 federal programs with receipts of approximately \$2 billion, and other independent auditors audited one federal program with receipts of approximately \$85 million for compliance with federal regulations. Further, since July 1990, we have issued ten special topic reports that include issues relating to education programs. These special topic reports required our office to review selected operations of three additional entities: the California State Summer School for the Arts; the California State University, Chico; and the University of California, San Francisco. (Appendix B lists the reports that the Office of the Auditor General issued from July 1, 1990, to December 31, 1991.)

We reported weaknesses for five departments within the area of education. In the following section, we discuss the most significant weakness we reported.

California Student Aid Commission

The California Student Aid Commission (commission) does not ensure the adequacy of efforts to collect on defaulted student loans that the commission purchased. Specifically, for 3 of 40 loans that we reviewed, the commission's service contractor or the assigned collection agency did not perform procedures required by federal law when attempting to collect defaulted student loans. Because the commission did not ensure that required collection procedures were followed, it could be losing payments on defaulted loans. In addition, failure to follow federal requirements for collections could jeopardize federal reimbursements and could result in the federal government's taking action against the commission's administration of the federal Guaranteed Student Loans program.

General Government

In fiscal year 1990-91, the State spent more than \$4 billion, approximately 5 percent of the State's expenditures, on general government. This area of government consists of 49 departments and other budgeted activities. In addition to our centralized testing and the audits performed by other independent auditors, our financial and compliance audit focused on four departments: the Office of Criminal Justice Planning, the Department of Economic Opportunity, the Department of Finance, and the Department of Personnel Administration. We audited three federal programs with receipts of approximately \$127 million for compliance with federal regulations. Since July 1990, we also have issued six special topic reports that include issues relating to general government. These special topic reports required our office to review the selected operations of five additional entities: the California Exposition and State Fair; the California Horse Racing Board; the Department of Food and Agriculture; the Department of Industrial Relations; and the 50th District Agricultural Association, the Antelope Valley Fair. (Appendix B lists the reports that the Office of the Auditor General issued from July 1, 1990, to December 31, 1991.)

We reported weaknesses for four of the departments that we audited within the area of general government. In the following section, we discuss the most significant weakness we reported.

Department of Personnel Administration

The Department of Personnel Administration (department) does not ensure that it properly accounts for the deferred compensation program. Specifically, as of March 1992, 21 months after it contracted with a firm to provide recordkeeping services, the department has not been able to ensure that it receives sufficient information to monitor the recordkeeping of the program. For example, for one investment plan, the department is not able to reconcile the plan's balance according to the plan's trustee with the balance according to the recordkeeper. At the end of the fiscal year, an unreconciled difference of approximately \$6.7 million existed between the trustee and the recordkeeper. Further, because the department did not receive sufficient information from the recordkeeper, the department may not be able to determine whether money is being properly invested. In one case, the department did not become aware of an error a plan trustee made in investing \$2.1 million of participant contributions until two months after the error occurred, resulting in lost interest of approximately \$118,000. Finally, because the department does not receive complete and accurate monthly detailed payment records or copies of tax deposit coupons and quarterly tax returns from the recordkeeper, the department is not able to ensure that it properly withholds and reports taxes.

Health and Welfare

In fiscal year 1990-91, the State spent more than \$31.3 billion, approximately 36 percent of the State's expenditures, on programs in the Health and Welfare Agency. The agency oversees the operations of 18 departments and other budgeted activities. In addition to our centralized testing, our financial and compliance audit focused on nine departments: the Department of Aging, the Commission on Aging, the Department of Alcohol and Drug Programs, the Employment Development Department, the Health and Welfare Agency Data Center, the Department of Health Services, the Department of Mental Health, the Department of Rehabilitation, and the Department of Social Services. We audited 25 federal programs with receipts of approximately \$11.8 billion for compliance with federal regulations. Further, since July 1990, we have issued 18 special topic reports that include issues relating

to Health and Welfare Agency programs. These special topic reports required our office to review the selected operations of one additional entity, the Department of Developmental Services. (Appendix B lists the reports that the Office of the Auditor General issued from July 1, 1990, to December 31, 1991.)

We reported weaknesses for six departments within the Health and Welfare Agency. In the following section, we discuss the most significant weaknesses we reported.

Department of Health Services

The Department of Health Services (department) has weaknesses in its collection of costs the department incurred to monitor and clean up hazardous waste sites. State law allows the department to recover from the liable parties the hazardous waste clean up costs incurred by the department as well as related administrative and interest costs. The department has not taken sufficient action to bill parties responsible for hazardous waste sites and to recover approximately \$222 million in costs the department has incurred. Consequently, as of February 28, 1991, it has billed only \$45 million and collected only \$16 million of the \$222 million incurred. The statute of limitations may prevent the department from recovering approximately \$31 million of the \$222 million. We reported these weaknesses in our report, *The Department of Toxic Substance Control Has Not Taken Sufficient Action To Bill and Recover Hazardous Waste Cleanup Costs From Responsible Parties* (F-426.1), issued in October 1991.

In addition the department has numerous weaknesses in its administration of its federal programs. For example, the department does not always ensure that payments remitted to State Legalization Impact Assistance Grant service providers are in accordance with approved contract rates or that invoices are correct before payments are made. In addition, for each month of fiscal year 1990-91, the department was late in reconciling the food vouchers it issued with the food vouchers redeemed by participants in the federal Special Supplemental Food Program for Women, Infants, and Children. Further, the State lost approximately

\$429,000 in potential interest earnings during fiscal year 1990-91 because the department delayed requesting federal reimbursements for a grant program.

**Legislative,
Judicial, and
Executive**

In fiscal year 1990-91, the State spent more than \$1.6 billion, approximately 2 percent of the State's expenditures, on the legislative, judicial, and executive area of government. This area of government consists of 34 departments and other budgeted activities. In addition to our centralized testing and the audits performed by other independent auditors, our financial and compliance audit focused on six departments: the Office of Emergency Services, the Board of Equalization, the Office of the Secretary of the Health and Welfare Agency, the Department of Justice, the State Controller's Office, and the State Treasurer's Office. We audited five federal programs with receipts of approximately \$184 million for compliance with federal regulations. Further, since July 1990, we have issued four special topic reports that include issues relating to the legislative, judicial, and executive areas of government. These special topic reports required our office to review the selected operations of one additional entity, the Legislative Analyst's Office. (Appendix B lists the reports that the Office of the Auditor General issued from July 1, 1990, to December 31, 1991.)

We reported weaknesses for four departments within the legislative, judicial, and executive areas of government. In the following section, we discuss the most significant weaknesses we reported.

Board of Equalization

The Board of Equalization (board) does not ensure that it is in compliance with the California Revenue and Taxation Code (code) related to unapplied credit balances on its business tax system. Consequently, in some cases, taxpayers did not receive tax refunds at the time they were entitled to receive them. However, in other cases, the board made refunds beyond the period allowed by the

code. At June 30, 1991, the board had approximately 18,000 credit balances, totaling more than \$59 million. Because the board does not ensure that it is in compliance with the code, the board cannot ensure that all taxpayers are receiving refunds when they are entitled to receive them.

In addition, the board does not have sufficient control over the unapplied credit balances. Specifically, the board has insufficient controls to prevent taxpayers from receiving credit twice for the same payment. Further, the board's system does not have controls to prevent the removal of credit balances from the unapplied credit file without accounting for the removal. Without sufficient controls over the credit balances, the board cannot ensure that errors and irregularities are detected and prevented.

Resources In fiscal year 1990-91, the State spent more than \$2.5 billion, approximately 3 percent of the State's expenditures, on programs in the Resources Agency. The agency oversees the operations of 26 departments and other budgeted activities. In addition to our centralized testing and the audits performed by other independent auditors, our financial and compliance audit focused on five departments: the Department of Boating and Waterways, the Department of Parks and Recreation, the State Lands Commission, the State Water Resources Control Board, and the Department of Water Resources. We audited one federal program with receipts of approximately \$78 million for compliance with federal regulations. Further, since July 1990, we have issued six special topic reports that included issues relating to programs in the Resources Agency. These special topic reports required our office to review the selected operations of five additional entities: the Department of Fish and Game, the Department of Conservation, the Department of Forestry and Fire Protection, the Seismic Safety Commission, and the State Coastal Conservancy. (Appendix B lists the reports that the Office of the Auditor General issued from July 1, 1990, to December 31, 1991.)

We reported weaknesses for two departments within the Resources Agency. See Table 1 on page 18 for the classification of these weaknesses.

State and Consumer Services

In fiscal year 1990-91, the State spent more than \$2.2 billion, approximately 2 percent of the State's expenditures, on programs in the State and Consumer Services Agency. The agency oversees the operations of 12 departments and other budgeted activities. In addition to our centralized testing and the audits performed by other independent auditors, our financial and compliance audit focused on eight departments: the Board of Architectural Examiners, the Board of Cosmetology, the Bureau of Electronic and Appliance Repair, the Department of Consumer Affairs, the Department of Fair Employment and Housing, the Franchise Tax Board, the Department of General Services, and the Public Employees' Retirement System. We audited one federal program with receipts of approximately \$352,000 for compliance with federal regulations. Further, since July 1990, we have issued 17 special topic reports that include issues relating to programs for the State and Consumer Services Agency. These special topic reports required our office to review the selected operations of three additional entities: the State Athletic Commission, the Medical Board of California, and the Board of Vocational Nurse and Psychiatric Technician Examiners. (Appendix B lists the reports that the Office of the Auditor General issued from July 1, 1990, to December 31, 1991.)

We reported weaknesses for eight departments within the State and Consumer Services Agency. In the following section, we discuss the most significant weakness we reported.

Franchise Tax Board

The Franchise Tax Board (board) has not sufficiently resolved weaknesses in its bank and corporation tax system that were initially identified by the board's internal audit unit. As a result of the insufficient resolution of the weaknesses, the board cannot ensure that all banks and corporations are receiving the refunds that they are legally entitled to receive.

**Youth and
Adult
Correctional**

In fiscal year 1990-91, the State spent more than \$2.7 billion, approximately 3 percent of the State's expenditures, on programs in the Youth and Adult Correctional Agency. The agency oversees the operations of six departments and other budgeted activities. In addition to our centralized testing and the audits performed by other independent auditors, our financial and compliance audit focused on three departments: the Board of Corrections, the Department of Corrections, and the Department of the Youth Authority. Since July 1990, we also have issued five special topic reports that include issues relating to programs for the Youth and Adult Correctional Agency. These special topic reports required our office to review the selected operations of five additional entities: the California Institution for Men, the California Institution for Women, the California Rehabilitation Center, the California Medical Facility, and the Correctional Training Facility. (Appendix B lists the reports that the Office of the Auditor General issued from July 1, 1990, to December 31, 1991.)

We reported weaknesses for three departments within the Youth and Adult Correctional Agency. See Table 1 on page 18 for the classification of these weaknesses.

**Report on the Study and Evaluation
of Internal Controls**



Kurt R. Sjoberg, Auditor General (acting)

State of California
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Independent Auditors' Report

Members of the Joint Legislative Audit Committee
State of California

We have audited the general purpose financial statements of the State of California as of and for the year ended June 30, 1991, and have issued our report thereon dated December 20, 1991. We did not audit the financial statements of the pension trust funds, which reflect total assets constituting 79 percent of the fiduciary funds. We also did not audit the financial statements of certain enterprise funds, which reflect total assets and revenues constituting 92 percent and 94 percent, respectively, of the enterprise funds. In addition, we did not audit the University of California funds. The financial statements of the pension trust funds, certain enterprise funds, and the University of California funds referred to above were audited by other auditors who furnished their reports to us, and our opinion, insofar as it relates to the amounts included for the pension trust funds, certain enterprise funds, and the University of California funds, is based solely upon the reports of other independent auditors. We have also audited the State of California's compliance with requirements applicable to major federal financial assistance programs and have issued our report thereon dated May 8, 1992.

We conducted our audits in accordance with generally accepted auditing standards; *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Circular A-128, *Audits of State and Local Governments*. Those standards and OMB Circular A-128 require that we plan and perform the audit to obtain reasonable assurance about whether the general purpose financial statements are free of material misstatement and about whether the State of California complied with laws and regulations, noncompliance with which would be material to a major federal financial assistance program.

In planning and performing our audits for the year ended June 30, 1991, we considered the State of California's internal control structure in order to determine our auditing procedures for the purpose of expressing our opinions on the State of

California's general purpose financial statements and on its compliance with requirements applicable to major federal financial assistance programs and not to provide assurance on the internal control structure.

The Department of Finance and the State's management are responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgements by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of general purpose financial statements in accordance with generally accepted accounting principles, and that federal financial assistance programs are managed in compliance with applicable laws and regulations. Because of inherent limitations in any internal control structure, errors, irregularities, or instances of noncompliance may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

For the purpose of this report, we have classified the significant internal control structure policies and procedures in the following categories: financial activities, including electronic data processing controls; state compliance; and federal compliance. We did not study the internal control structures for the pension trust funds, certain enterprise funds, or the University of California funds.

For all of the internal control structure categories listed above, we obtained an understanding of the design of relevant policies and procedures and determined whether they have been placed in operation, and we assessed control risk.

Because of the large number of nonmajor programs and the decentralized administration of these programs, we performed procedures to obtain an understanding of the internal control structure policies and procedures relevant to nonmajor programs on a cyclical basis. Our procedures during the current year covered 48 percent of the nonmajor programs administered by the State as a whole. The nonmajor programs not covered during the current year have been or are expected to be subject to such procedures at least once during the three-year cycle.

During the year ended June 30, 1991, the State of California received 97 percent of its total federal financial assistance under major federal financial assistance programs. We performed tests of controls, as required by OMB Circular A-128, to evaluate the effectiveness of the design and operation of internal control structure policies and procedures that we considered relevant to preventing or detecting material noncompliance with specific requirements, general requirements, and requirements governing claims for advances and reimbursements and amounts claimed or used for matching that are applicable to each of the State of California's major federal financial assistance programs, which are identified in the accompanying schedule of federal financial assistance. Our procedures were less in scope than would be necessary to render an opinion on these internal control structure policies and procedures. Accordingly, we do not express such an opinion.

The results of our audit disclosed certain matters involving the internal control structure and its operations that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgement, could adversely affect the State's ability to record, process, summarize, and report financial data consistent with the assertions of management in the general purpose financial statements or to administer federal financial assistance programs in accordance with applicable laws and regulations.

We discuss the reportable conditions and present recommendations to correct them on pages 55 through 274 of our report. Management's comments regarding the recommendations appear on page 345 of this report. Additionally, beginning on page 325, we present a schedule listing instances of noncompliance that we consider to be minor. Specific responses to the reportable conditions identified at each state agency are on file with the Office of the Auditor General and the Department of Finance. The reportable conditions identified in the State's single audit report for fiscal year 1989-90 that have not been corrected are included in the section beginning on page 55.

In addition to the work we performed in accordance with the OMB Circular A-128 and the Single Audit Act of 1984, we performed other reviews related to federal programs. A schedule of the pertinent reports issued from July 1, 1990, to December 31, 1991, begins on page 317 of this report.

This report is intended for the information of the California State Legislature, including the Joint Legislative Audit Committee, and the management of the executive branch. This restriction is not intended to limit the distribution of this report, which, upon acceptance by the Joint Legislative Audit Committee, is a matter of public record.

OFFICE OF THE AUDITOR GENERAL



CURT DAVIS, CPA
Deputy Auditor General

May 8, 1992

Detailed Description of Weaknesses at State Agencies

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Deficiencies Common to Various Agencies

Summary Certain deficiencies in internal control are common to more than one agency. For example, many state agencies do not comply with the California Public Contract Code in establishing and maintaining contracts with vendors. Furthermore, not all internal audit units that we reviewed fully complied with professional standards. Additionally, many state agencies do not have adequate controls over equipment. Also, many state agencies do not promptly use federal funding that has already been received. Finally, not all state agencies promptly return undelivered salary warrants to the State Controller's Office.

We discovered these and other deficiencies when we performed our annual financial and compliance audit of the State. We have reported these systemic deficiencies to the Department of Finance, which is the agency that has general supervisory responsibility over all matters concerning the financial and business policies of the State. In the following paragraphs, we discuss the deficiencies we found.

Deficiencies in Administering State Contracts

State agencies do not always comply with the California Public Contract Code in establishing and maintaining contracts with vendors. In our reviews of 160 nonconsultant contracts at 16 departments, we found 46 contracts that were not approved before the beginning of contract work. When agencies do not ensure that contracts are approved before work begins, the State cannot be assured that its interests are protected. In addition, if these contracts had not been subsequently approved, the State

might still have been liable for the work performed and might have incurred litigation costs regarding the State's obligation to pay for that work. Table 2 below indicates the departments at which we reviewed nonconsultant contracts, the number of contracts reviewed at each department, and the number of reviewed contracts for which work began before contract approval.

**Table 2 Deficiency in Administering
State Nonconsultant Contracts at Various Agencies
Fiscal Year 1990-91**

Agency Name	Contracts Tested	Lack of Approval Before Start of Contract Work
Department of Social Services	10	7
Department of Health Services	10	6
California Department of Education	10	6
Employment Development Department	10	5
California Community Colleges, Chancellor's Office	10	5
Department of the Youth Authority	10	4
Department of Water Resources	10	4
Department of Corrections	10	3
State Treasurer's Office	10	3
Franchise Tax Board	10	2
Department of Motor Vehicles	10	1
State Controller's Office	10	0
Board of Equalization	10	0
Department of General Services	10	0
Department of Transportation	10	0
Department of Mental Health	10	0
	160	46

The California Public Contract Code, Section 10295, states that all contracts, unless otherwise exempt, entered into by any state agency for the purchase of equipment, supplies, materials, services, or construction are void unless or until approved by the department. In addition, Section 10335 states that, unless specifically exempted, a service contract is not effective until the date of its approval. Moreover, the State Administrative Manual, Section 1209, requires state agencies to submit each contract in sufficient time for the Department of General Services to review and comment on it before

work on the contract begins, except in emergency cases to protect human life or state property. This section of the manual also states that a contractor who begins work before receiving notice of the contract's approval may be considered to have performed the work at the contractor's own risk and may not be paid.

Table 2 pertains specifically to our review of nonconsultant contracts. In our report, *An Analysis of the State's Compliance With Requirements for Consultant Contracts* (F-066), issued in January 1992, we reported on our review of consultant contracts. We reported that the State is not always complying with the requirements that consultant contracts be approved before contract work is begun, that contracting departments review prior evaluations of contractors being considered for new contracts and review resumes of persons expected to perform contract work, and that evaluations of contractors be completed within 60 days of the completion of the contract. In addition, we reported that the evidence supporting some of the explanations provided to justify sole-source contracting was inadequate.

**Variances From
Internal Audit
Standards**

Twelve of the 13 internal audit units reviewed did not fully comply with the Standards for the Professional Practice of Internal Auditing of the Institute of Internal Auditors, Inc. Although some deficiencies were noted at all 13 of the internal audit units, only one, the Department of Corrections, exhibited deficiencies significant enough to impair its ability to carry out its responsibilities.

The California Government Code, Section 1236, requires the internal audit units of state agencies to comply with the Standards for the Professional Practice of Internal Auditing (standards) of the Institute of Internal Auditors, Inc. In addition, Section 10529 requires the Department of Finance to ensure that the internal audit units use these professional standards. Finally, Section 10529 requires the Office of the Auditor General to report on the internal audit units' compliance with the standards.

During fiscal year 1990-91, the Department of Finance (department) reviewed the internal audit units of 13 state agencies for compliance with professional standards. We examined the department's work and performed limited testing at four of the internal audit units that the department had reviewed to establish our reliance on the department's work. The variances from the professional standards that the department identified are summarized on Table 3 below.

Table 3
Summary of Variances From Professional Standards
for Internal Auditors
Distribution by State Agency
Fiscal Year 1990-91

	Independence	Professional Proficiency	Scope of Work	Performance of Audit Work	Management of Internal Auditing Department
California State Lottery Commission	X	X		X	X
Department of Consumer Affairs	X			X	
State Teachers' Retirement System	X				X
Department of Transportation	X			X	X
Department of Motor Vehicles			X		X
Department of the California Highway Patrol			X		
Department of Water Resources	X				X
Department of Alcohol and Drug Programs				X	X
Department of Health Services			X	X	X
Department of Corrections			X	X	X
California Department of Education			X		X
California Student Aid Commission	X	X		X	X
State Board of Control	X				X

An internal audit unit is a basic component of internal control. These units provide management with recommendations to remedy internal control weaknesses, thus increasing overall efficiency of the agencies' operations. Unless internal audit units follow professional standards, management cannot be certain that they can rely upon the work of the internal auditors.

Weaknesses in Controls Over Equipment

State agencies do not always establish and maintain adequate internal controls over equipment as prescribed by the State Administrative Manual. We tested controls over equipment at 39 locations and found that 19 locations had weaknesses in controls over their physical inventory counts and equipment reconciliations. Specifically, state agencies did not always perform complete physical counts of equipment every three years and did not always adjust their accounting records based on the results of the counts. In addition, some state agencies had inadequate separation of duties over their physical inventory counts. Finally, state agencies did not always prepare equipment reconciliations as often as required and did not always have adequate reconciliation processes. Because of the weaknesses in controls over equipment noted, the State is exposing itself to an increased risk of the loss of equipment. Table 4, page 50, provides details of the deficiencies in internal controls over equipment, by agency.

Table 4
Deficiencies in Internal Controls Over Equipment
Distribution by State Agency
Fiscal Year 1990-91

Agency	Insufficient Physical Inventory Counts	Inadequate Separation of Duties	Insufficient Property Reconciliations
Air Resources Board	X	X	
California State Universities (Three universities)	X		X
Corrections, Department of (Three institutions)	X		X
Developmental Services, Department of (Headquarters and three centers)	X	X	X
Employment Development Department	X		X
Health Services, Department of	X	X	X
Justice, Department of	X		
Motor Vehicles, Department of	X		
Parks and Recreation, Department of			X
Social Services, Department of	X		
Transportation, Department of (Headquarters and one district)	X	X	X

The State Administrative Manual, Section 8652, establishes guidelines for an inventory plan, which state agencies are responsible for developing and carrying out. These guidelines specify requirements for the frequency of physical counts of equipment, adjustment of accounting records based on the counts, and separation of duties over the counts. The State Administrative Manual, Section 7969, requires state agencies to reconcile periodically the amount of expenditures for equipment with the amount of equipment added to the property ledger.

Improper Cash Management

During fiscal year 1990-91, many state agencies maintained balances of federal funds that exceeded their immediate cash needs in appropriations related to prior years. For example, the Department of Economic Opportunity retained between \$.9 million and \$6.6 million during fiscal year 1990-91 of excess federal funds in the state treasury for certain prior year appropriations. Further, we determined that the Department of Industrial Relations retained between approximately \$.5 million and approximately \$1 million during fiscal year 1990-91 of excess federal funds in the state treasury for certain prior year appropriations.

The State as a whole had on deposit approximately \$263.5 million in federal funds as of June 30, 1991, for all fiscal years' appropriations. Table 5, page 52, provides bimonthly end-of-month balances of these deposits during fiscal year 1990-91 by year of appropriation. Some of the balances, particularly those for fiscal year 1990-91, may be amounts representing the State's cash needs to make payments in the immediate future. Also, some of the balances represent amounts that have not been transferred to the State's General Fund even though the General Fund is entitled to the money. For example, the Department of Forestry and Fire Protection had approximately \$153,700 of federal funds on deposit even though the money should have been transferred to the General Fund. In addition, some of the balances represent settlements received by the State, such as Outer Continental Shelf funds, that the State is allowed to maintain until it uses the funds. For example, the Department of Transportation had \$4 million of Outer Continental Shelf funds on deposit as of June 30, 1991. However, we believe many of the balances, particularly those for prior years' appropriations, represent pools of federal funds that exceed the immediate needs of the State.

**Table 5 Balances of Federal Funds on Deposit
During Fiscal Year 1990-91
(in thousands)**

Appropriation Fiscal Year	August 1990	October 1990	December 1990	February 1991	April 1991	June 1991	12-Month Annual Average
1984-85	\$ 15	\$ 15	\$ 15	\$ 15	\$ 15	\$ 0	\$ 14
1985-86	7,817	6,524	5,857	5,912	5,912	5,791	6,313
1986-87	4,240	4,778	4,884	7,036	3,564	11	4,371
1987-88	7,662	6,118	6,696	7,080	24,727	3,142	9,448
1988-89	19,207	8,277	10,147	13,298	20,852	22,834	15,438
1989-90	80,480	35,071	26,404	29,850	21,314	12,959	46,255
1990-91	100,641	106,576	171,625	108,964	60,841	37,527	77,172
Continuously Appropriated	19,649	31,541	64,309	49,828	58,101	181,241	69,382
Total	\$239,711	\$198,900	\$289,937	\$ 221,983	\$ 195,326	\$ 263,505	

Because the State did not properly limit its requests for federal funds to its immediate cash needs, the federal government lost interest that it could have earned on these funds. In addition, maintaining excess cash may result in the termination of advanced financing by the federal government.

The Code of Federal Regulations, Title 31, Section 205.4, requires that cash advances be limited to the actual immediate cash needed for carrying out the purpose of the program. This section also stipulates that the timing and amount of cash advances be as close as administratively feasible to the actual disbursement by the recipient organization.

Salary Warrants Are Not Always Promptly Returned

State agencies do not always return undelivered salary warrants to the State Controller's Office within 90 calendar days of receipt. We performed tests for undelivered salary warrants more than 90-days old at 67 locations and found that 6 locations did not return a total of 65 salary warrants to the State Controller's Office within 90 days of receipt. These warrants ranged in amount from \$0.59 to \$6,006.80. The oldest warrant found was dated April 17, 1987, and amounted to \$30.40. Failure to return the undelivered warrants to the State Controller's Office increases the risk of their loss or misappropriation. Table 6 below provides, by agency, the number of undelivered salary warrants that were more than 90-days old.

Table 6 Salary Warrants Not Returned Within 90 Days

Agency	Number of Warrants More Than 90-Days Old
Corrections, Department of (Headquarters and one institution)	8
Developmental Services, Department of (One hospital)	1
General Services, Department of	48
Transportation, Department of (Two districts)	8
Total	65

The State Administrative Manual, Section 8580.5, specifies that salary warrants not delivered within 90 calendar days of receipt must be returned to the State Controller's Office for monthly deposit in the special deposit fund.

Management Letters by Area of Government

Business, Transportation and Housing

Department of Motor Vehicles

We reviewed the financial operations and related internal controls of the Department of Motor Vehicles (department).

Inadequate Control Over Dishonored Checks

Finding

The department does not have sufficient control over the collection of dishonored checks. As of June 30, 1991, the department had approximately \$13.4 million in checks that banks had not honored. This is an increase of \$3.2 million from the amount we reported in our audit report for fiscal year 1989-90.

As we also reported for fiscal year 1989-90, we determined that two of the three units responsible for the collection of dishonored checks are not notifying the revenue collection unit when they receive payment on these checks. Thus, these payments are not being processed as collections of dishonored checks. Instead, the payments are being forwarded to the accounting unit and recorded as revenue. As a result of processing payments of dishonored checks as revenue and not updating the dishonored check system, the department is recording the revenue twice and overstating the recorded amount of dishonored checks.

We also found that none of the three units notify the revenue collection unit when they determine that certain checks are uncollectible. Consequently, these uncollectible checks are not deleted from the list of dishonored checks and are not added to the relief of accountability listing that is submitted to the Board of Control for write-off.

Further, because only the revenue collection unit participates in the Franchise Tax Board's Offset Program, which offsets the amount owed to a state agency by reducing an individual's tax refund for

the amount owed, the department's use of the program has been limited. Because of this limited use, the department may not recover amounts due from dishonored checks. Also, the department is not following appropriate collection procedures; for example, none of the four units responsible for collection of dishonored checks ensures that three collection letters are sent for delinquent receivables in an effort to clear dishonored checks.

In addition, the financial responsibility unit routinely waives penalties assessed against uninsured motorists involved in an accident even though the penalty is paid with a dishonored check. However, the department has no written policy allowing waivers of the penalties. Specifically, the department issues a restricted license, valid for one year, to uninsured motorists who have been involved in an accident. The restricted license is issued when an individual pays a \$250 penalty. We determined that when a check for the \$250 penalty is not honored by the bank, the unit suspends the restricted license on its computer system. However, it routinely waives the \$250 penalty at the end of one year. Thus, the department is forfeiting an unspecified amount of revenue it could be collecting.

During our audit for fiscal year ended June 30, 1990, we reviewed 17 checks from the department's listing of dishonored checks. These checks were dated from July 1985 to March 1989. One of the 17 checks had not been added to a list for collection. Further, for 6 checks, totaling \$12,722, the department was unable to locate or determine their disposition. For the remaining 10 checks, we determined that collection efforts had been exhausted. However, the department had not submitted the dishonored checks to the Board of Control for write-off or to the Franchise Tax Board for offset. During the current audit, we reviewed the status of these checks again and determined that the department has still not taken corrective action on these dishonored checks.

Finally, during our current audit, we reviewed an additional 15 checks from the department's listing of dishonored checks. These checks were dated from April 1989 through June 1990. We

noted exceptions in 14 of the 15 checks reviewed. For 3 checks totaling \$10,673, the department was unable to locate the checks or to determine their disposition. Further, for another 2 checks, totaling \$2,713, collection efforts were not completed promptly. For example, collection efforts on one of these checks did not begin until approximately two years after it was dishonored. Also, for one of these dishonored checks, totaling \$1,570, the department erroneously issued a refund check. For another 3 of the checks, replacement payments had been received, but the checks were still on the dishonored checklist. Finally, for the remaining 6 dishonored checks, totaling \$17,205, we determined that collection efforts had been exhausted. However, the department had not submitted any of the dishonored checks to the Board of Control for write-off and had not submitted 4 of the dishonored checks to the Franchise Tax Board for offset. The department's failure to quickly identify and obtain collection of dishonored checks can reduce the potential for collecting these monies.

A lack of centralized control over the collection of dishonored checks has caused these weaknesses. The department has not given primary responsibility for the processing of dishonored checks to one of the four units involved in the collection of dishonored checks. Thus, all four units at the department act independently, hampering collection efforts. In response to this condition noted in our management letter for fiscal year 1989-90, the director responded that an interim procedure to provide adequate control and tracking of dishonored checks was planned for June 1991. As of April 1992, the new procedure had not been implemented.

Criteria

The California Government Code, Section 13403(a)(3), states that the elements of a satisfactory system of internal accounting and administrative control should include, but are not limited to, a system of authorization and recordkeeping procedures that effectively control assets, liabilities, revenues, and expenditures. The California Vehicle Code, Section 16072, states that, in lieu of suspending the driving privilege of an uninsured motorist who has been involved in an accident and has failed to maintain proof of

financial responsibility, the department may, upon application, restrict the person's driving to necessary travel. The person is eligible for this restriction if he or she files and thereafter maintains proof of financial responsibility and pays a penalty to the department of \$250. Moreover, the State Administrative Manual, Section 8776.6, states that departments must develop collection procedures that will ensure prompt follow-up on receivables. In addition, this section requires departments to send a sequence of three collection letters for delinquent receivables.

Recommendation

The department should centralize the process for identifying and collecting dishonored checks. The department should establish written procedures for processing payments received on dishonored checks and ensure that department staff involved in the collection of dishonored checks are aware of these procedures. If the department intends to waive penalties assessed against uninsured motorists, that policy should be in writing and approved by the director. The department should provide to the Board of Control a listing of checks for which collection efforts have been exhausted, and the department should attempt collection of all dishonored checks through the Franchise Tax Board's offset program.

Insufficient Documentation of Refunds	Finding
	<p>The department does not obtain sufficient documentation to support refunds issued to individuals. The department issues three types of refunds: one type when it issues cash and two types when it issues a check. During fiscal year 1990-91, the department issued check refunds totaling approximately \$16.3 million and cash refunds of an undetermined amount.</p> <p>We reviewed 15 check refunds. For 3 of the 15 refunds, totaling \$5,620, the department was unable to support the amount of the refund. In addition, for one of these refunds, totaling \$3,727, the department did not document the reason for the refund. Further, we were unable to test cash refunds because the department discards</p>

the documents related to cash refunds after the cash collection reports are balanced. Further, because of the lack of documentation, the department was unable to determine the total cash refunds the department issued in fiscal year 1990-91.

As a result of not obtaining proper documentation or maintaining adequate records to support refunds, the department cannot ensure that all refunds are appropriate and, thus, has made itself susceptible to fraud and abuse.

Criteria

The California Government Code, Section 13403(a)(3), states that the elements of a satisfactory system of internal accounting and administrative control should include, but are not limited to, a system of authorization and recordkeeping procedures that effectively control assets, liabilities, revenues, and expenditures. The California Vehicle Code, Sections 42231 and 42232, state that a person who has paid an erroneous or excessive or not-legally- due amount, may apply for a refund within three years after the date of the payment or collection. Further, the California Vehicle Code, Section 42232, also states that the application for refund should identify the payment made and state the grounds upon which it is claimed to be excessive or erroneous.

Recommendation

The department should establish procedures to obtain documentation that supports the refunds issued and should retain this documentation for at least three years. If the department does not wish to maintain documentation on cash refunds for three years, the documentation should be retained until the department's internal audit staff tests these cash refunds as part of their field office reviews.

Insufficient Control Over Access to Electronic Data Processing Programs and Data Files

Finding

The department's electronic data processing (EDP) personnel have unrestricted access to programs and data files. For example, EDP personnel can access data files and use this information to run programs without following the department's authorization procedures.

In response to the previous year's finding on this same issue, the director stated that the new process to address this weakness would be in place no later than February 15, 1991. However, according to the director, this new process was not developed by February 15, 1991, but the department has been working on implementing the new process and now plans to complete the implementation by August 1993.

Failure to restrict access to programs and data files could result in unauthorized changes to these programs and files. Further, possible disclosure or misuse of confidential information contained in department data files could occur.

Criteria

The California Government Code, Section 11771, requires agencies to maintain strict controls over EDP systems to prevent unauthorized access to programs and data files. In addition, the State Administrative Manual, Section 4841.3, states that automated files and data bases must be given appropriate protection from loss, inappropriate disclosure, and unauthorized modification.

Recommendation

The department should ensure that only authorized personnel are allowed access to the EDP systems and only during the performance of authorized duties.

Improper Reporting of Encumbrances and Improper Classification of Obligations

Finding

The department did not accurately analyze its listing of payables to determine which items represented encumbrances or obligations. Under generally accepted accounting principles, encumbrances are amounts committed for goods or services ordered but not received by June 30. The department improperly reported to the State Controller's Office approximately \$3.7 million as encumbrances rather than obligations even though these items represented goods or services received as of June 30. Further, the department incorrectly classified on its financial statements, approximately \$6.2 million, as payables that were due to other funds.

Failure to analyze and report encumbrances and obligations accurately to the State Controller's Office reduces the ability of the State Controller's Office to prepare the State's financial statements accurately and in accordance with generally accepted accounting principles.

Criteria

The State Administrative Manual, Section 10544, requires agencies to analyze their obligations and encumbrances as of June 30 and to determine whether they received the goods and services before or after June 30. In addition, the State Administrative Manual, Section 7630, states that agencies should report amounts due to other funds in the due to other funds or appropriations summary account.

Recommendation

The department should analyze its commitments to determine whether it received the goods and services before or after June 30 and to ensure that obligations are properly classified so that it appropriately reports amounts to the State Controller's Office.

Stephen P. Teale Data Center

We reviewed the financial operations and related internal controls of the Stephen P. Teale Data Center (data center).

Weak Internal Control Environment

Finding

The data center does not foster a strong internal control environment. Specifically, we noted that the data center's management has not provided adequate direction to correct internal control problems in its accounting unit. As a result, the data center has not corrected many of the deficiencies we found in our previous financial audits. We are repeating these audit findings in items 4 through 9. In addition to those findings, we noted the following weaknesses:

- The manager in the fiscal accounting unit prepares journal entries and posts these entries to the general ledgers and subsidiary records. Because the manager is involved in bookkeeping activities, he cannot effectively review accounting transactions to minimize errors. The data center should delegate the bookkeeping activities to a lower-level employee.
- We found that the data center's accounting methods are inefficient and do not always provide adequate support for the financial statements. For example, we found that the data center maintains a manual and a computerized receivable subsidiary ledger. It is not necessary that the data center maintains two ledgers. In addition, the amounts in the two subsidiary ledgers differed by approximately \$2 million and neither amounts agreed with the data center's financial statements. We also noted that one of the data center's control accounts was not supported by a detailed schedule. Because the balance in the control account at June 30, 1991, was not

supported by a detailed schedule, in our audit of installment contracts payable, we had to calculate the outstanding balance of contracts at June 30, 1991.

Without an adequate system of internal accounting and administrative controls, the data center cannot ensure that its financial records are accurate and that its assets are safeguarded. Also, the data center's billings to other state agencies may not be accurate because its billings are based on its financial records.

Criteria

The California Government Code, Section 13401, requires state agencies to maintain a system of internal accounting and administrative controls. The California Government Code, Section 13403, states that a satisfactory system of internal accounting and administrative controls includes a system of procedures adequate to provide effective accounting controls over assets, liabilities, revenues, and expenditures.

Recommendation

The data center should establish and implement a satisfactory system of internal accounting and administrative controls.

Possible Liability to the Federal Government

Finding

The State has a possible liability to the federal government of up to \$4.0 million for the federal share of profits accumulated by the data center in its revolving fund from July 1, 1984, through June 30, 1991. In addition, the State may also owe the federal government for interest costs incurred by the data center in financing its equipment acquisitions. The unallowable interest charges totaled approximately \$1.1 million during fiscal years 1987-88 through 1990-91.

The data center's revolving fund is an internal service fund that provides data processing and related services to state agencies. The data center has charged these agencies more than its costs for

providing services. In turn, state agencies have passed on a portion of the charges to federal programs. The revolving fund accumulates profits when its charges for services exceed its costs. Federal regulations prohibit the State from charging federal programs for more than its costs. Federal regulations also prohibit the State from charging interest costs to federal programs.

In 1984, the federal Department of Health and Human Services (DHHS) audited the rate setting methods of the State's internal service funds. The audit covered July 1, 1969, to June 30, 1984. As a result of the audit, the State refunded to the federal government approximately \$14.9 million in 1986. This amount was the federal share of profits accumulated by five of the State's internal service funds during the period covered by the audit. Of this amount, the State charged approximately \$1.2 million to the data center's revolving fund. Based on a Department of Finance analysis, the \$1.2 million represented 14.8 percent of \$8 million in accumulated profits of the data center at June 30, 1984. From July 1, 1984, to June 30, 1991, the data center's accumulated profits have increased by approximately \$27 million, after audit adjustments. The State may be liable to repay the federal government some of the accumulated profits.

Using procedures similar to those of the Department of Finance and using the same ratio of 14.8 percent, we estimate that, under current federal regulations, the State may owe the federal government approximately \$4.0 million. This amount is the federal share of profits accumulated by the data center from July 1, 1984, through June 30, 1991. However, proposed changes to federal regulations may reduce the State's liability to the federal government to approximately \$2.5 million.

The data center also charged state agencies for interest costs for equipment acquisitions. Federal regulations prohibit the State from charging interest costs to federal programs. We used the same ratio of 14.8 percent to estimate charges to federal programs for unallowed interest costs for equipment acquisitions during fiscal years 1987-88 through 1990-91. We concluded that the State may

have an additional liability to the federal government, under current regulations, of approximately \$1.1 million for the federal share of interest costs for equipment acquisitions incurred by the data center during these four fiscal years. For fiscal years 1984-85 through 1986-87, the data center did not separately disclose in its records interest costs for equipment acquisitions. Therefore, we did not calculate the State's potential liability to the federal government for the federal share of interest costs for those years.

According to data center officials, the federal share of state agencies' charges to federal programs in May 1986 was approximately 3.6 percent and is projected to be 1.84 percent in fiscal year 1990-91. According to the data center's estimate of federal participation of 1.84 percent, the center may have a possible liability to the federal government of at least approximately \$499,000 for the federal share of profits and approximately \$136,000 in unallowable interest. Because the federal government and the state executive branch are ultimately responsible for negotiating any final settlement, we did not attempt to compute the actual percentage of the federal share of state agencies' charges to federal programs.

The possible liabilities to the federal government exist primarily because the data center's billing system is not designed to recover only the allowable cost that the data center incurs in providing services. Instead, it is also designed to provide the additional money needed to cover the cash flow of the data center, including additional investments in equipment.

We reported a similar finding during our financial audit for fiscal years 1988-89 and 1989-90. We recommended that the Department of Finance (DOF) ensure that the State comply with federal and state regulations. We suggested that the DOF develop guidelines for the data center and for state agencies that receive services from the data center. In his response on March 18, 1991, the director of the DOF stated that the State is working with the federal government to minimize the differences between state and federal laws and regulations. He stated that once the differences are resolved, the DOF will develop guidelines for the internal service funds.

Criteria

The California Government Code, Section 13070, provides the DOF with general powers of supervision over all matters concerning the financial and business policies of the State. The California Government Code, Section 11754, allows the data center to accumulate profits in its revolving fund up to certain limits. However, the federal Office of Management and Budget, Circular A-87, "Cost Principles for State and Local Governments," currently prohibits the State from charging federal programs for amounts that exceed costs. In addition, Circular A-87 prohibits states from charging federal programs for interest costs.

Proposed amendments to Circular A-87 would allow the State to retain a reasonable working capital reserve of up to 60 days' cash expenditures, excluding the costs for capital items. If this proposed amendment is approved and applied retroactively, the State's potential liability to the federal government for accumulated profits of the data center may be reduced. In addition, the proposed amendments would make interest costs on equipment acquisitions on or after January 1, 1989, allowable.

Recommendation

The data center and the DOF should develop accounting procedures to ensure that the State complies with federal and state regulations. Compliance could be ensured by developing guidelines for the data center and for state agencies that receive services from the data center.

Some Service Costs Not Fully Recovered

Finding

The data center's charges to the Department of Motor Vehicles (DMV) and the California Student Aid Commission (commission) for certain services that the center provided to them were not based on the data center's service rate schedule. During fiscal year 1990-91, the data center provided conversion processing and data base redevelopment services to DMV worth approximately \$15.8 million. However, the data center charged and collected

only approximately \$14 million so that the undercharge was \$1.8 million. In fact, cumulatively, the data center has undercharged the DMV approximately \$13.8 million over the last four years. In addition, the data center reduced its receivable by approximately \$753,000 for computer services it provided to the commission. The data center was unable to support this reduction.

In our opinion, the data center's charges are inequitable because the data center charges state agencies, other than the DMV and the commission, based on its service rate schedule. Also, a disproportionately large share of the data center's costs have been passed on to other state funds, including the State's General Fund, and to federal programs.

We reported the finding related to DMV during our audits for fiscal years 1988-89 and 1989-90. In its response in March 1991, the data center stated that it verbally agreed to provide conversion-related services to the DMV for fixed amounts instead of charging for actual work load at then-current published Teale rates.

Criteria

The State Administrative Manual, Section 8752, specifies that state policy requires agencies to recover full costs. All state agencies, regardless of funding sources, are required to follow this policy in all cases, except where statutes prohibit full cost recovery. Also, the State Administrative Manual, Section 4982.2, requires the State's data centers to charge their users for units of service based on their published service rate schedules.

Recommendation

The data center should consistently charge its users for services provided based on its published service rate schedule.

Weaknesses in Separating Accounting Duties

Finding

The data center does not have adequate separation of duties in its accounting section. Specifically, we noted the following conditions:

- The person who signs checks also authorizes disbursements, prepares and approves all journal entries, and maintains the general ledger. He also prepares the bank reconciliations when the person who usually performs this task is unable to do so. The same person prepares journal entries to record equipment, posts these entries to the general ledger, and reconciles the property records. We reported a similar weakness during our financial audit for fiscal year 1989-90.
- The person who receives and deposits remittances also maintains the receipts and disbursements registers and prepares the bank reconciliations.
- The person who prepares purchase orders and orders the merchandise also, at times, receives the delivery of the merchandise.

Failure to adequately separate accounting duties can result in errors, irregularities, or illegal acts that may go undetected for extended periods.

Criteria

The State Administrative Manual, Section 8080, requires state agencies to separate functions so that the person who signs checks does not authorize disbursements or reconcile bank accounts and does not maintain the general ledger or any subsidiary ledgers affected by cash transactions. Section 8080 also requires state agencies to separate functions so that the person who receives and deposits remittances does not maintain the cash receipts register and the cash disbursements register and does not reconcile bank accounts. The California Government Code, Section 13401, requires state agencies to maintain a system of internal accounting and administrative controls. Good internal controls require

separation of the functions of purchasing and receiving merchandise and the functions of recording and reconciling equipment.

Recommendation

The data center should separate its accounting duties to comply with the requirements in the California Government Code and the State Administrative Manual.

Weaknesses in Controls Over Equipment

Finding

The data center has weaknesses in its control over equipment. We noted the following conditions:

- The data center has no records to show that it has taken a physical inventory of its equipment within the last three fiscal years. We reported a similar weakness in our financial audit for fiscal years 1987-88 through 1989-90.
- The data center's equipment identification numbers listed in its property records frequently did not agree with the identification numbers assigned to the equipment. We could not trace five of the ten items we tested to the property records. We reported a similar weakness in our financial audit for fiscal years 1987-88 through 1989-90.
- We found that the data center did not always prepare the stock-received report promptly. We noted that the data center dated two stock-received reports approximately six and eight months after the acceptance of the equipment. Delays in preparing the stock-received reports contribute to errors and inefficiencies in the accounting for equipment.

The data center's failure to maintain sufficient accountability for its equipment prevents prompt detection of errors and exposes state property to increased risk of loss.

Criteria

The State Administrative Manual, Section 8652, requires agencies to make a physical count of all property at least once every three years and to reconcile the physical count with the accounting records. In addition, the State Administrative Manual, Section 8422.20, requires state agencies to forward stock-received reports directly to their accounting unit on the day goods are received.

Recommendation

The data center should comply with the requirements contained in the State Administrative Manual and strengthen its control over equipment.

Weaknesses in Accounting for Equipment

Finding

The data center has weaknesses in its accounting for equipment. Specifically, we noted the following conditions:

- The data center does not always ensure that its acquisition of equipment by installment contract is recorded correctly. For example, equipment worth approximately \$214,000 was accepted on February 15, 1991. However, the data center had not recorded in the equipment account any of this amount by June 30, 1991. We reported a similar weakness during our financial audit for fiscal years 1988-89 and 1989-90.
- The data center improperly included in the equipment account approximately \$196,000 in software costs. Software costs should be recorded in a separate asset account. We reported a similar weakness during our financial audit for fiscal years 1988-89 and 1989-90.
- The data center improperly recorded approximately \$157,000 of equipment twice. We reported a similar weakness during our financial audit for fiscal year 1989-90.

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- The data center improperly included in its equipment balance approximately \$229,000 of finance charges on two installment contracts.
 - The data center has still not removed from its equipment balance at June 30, 1991, eight items of equipment that it sold or removed from service before the end of fiscal year 1989-90. The total value of the eight items was approximately \$1.2 million. We reported this problem during our financial audit for fiscal years 1988-89 and 1989-90.

The data center's failure to properly account for its equipment increases the risks of material misstatements in its fixed assets and depreciation expense accounts.

Criteria

The California Government Code, Section 13401, requires state agencies to maintain a system of internal accounting and administrative controls. The California Government Code, Section 13403, states that a satisfactory system of internal accounting and administrative controls includes a system of procedures adequate to provide effective accounting controls over assets, liabilities, revenues, and expenditures. Also, the State Administrative Manual, Section 8632, requires agencies to exclude any interest or other operating costs in recording assets purchased by installment. In addition, the State Administrative Manual, Section 8621, requires agencies to remove disposed property from the accounting records.

Recommendation

The data center should comply with the requirements contained in the California Government Code and the State Administrative Manual to improve its accounting over equipment.

**Failure
To Record
Software Costs
as Intangible
Assets**

Finding

The data center records the cost of the software it purchases as an operating expense rather than as an intangible asset. Intangible assets are assets that lack physical substance but give valuable rights to the owner. State regulations require state agencies to record certain software costs as intangible assets and to systematically allocate the cost of the software to expenses over its useful life. We identified two agencies that employ a useful life of five years for software. Because the data center recorded its software purchases as expenses immediately, it overstated its operating expenses for fiscal year 1990-91 by approximately \$496,000. In addition, the cumulative effect of not having recorded intangible assets in the past was to understate assets (net of amortization) at June 30, 1991, by approximately \$5 million.

We reported a similar weakness during our financial audit for fiscal years 1988-89 and 1989-90.

Criteria

The State Administrative Manual, Section 8615.1, requires state agencies to record intangible assets that have an expected life of at least four years and cost at least \$5,000. Section 8615 describes the cost of purchasing software as an intangible asset. Finally, the State Administrative Manual, Section 8621, requires proprietary funds such as the Stephen P. Teale Revolving Fund to record amortization. The State Administrative Manual, Section 8617, describes amortization as allocation of the cost of software, less its estimated residual value, to expense over the periods benefited.

Recommendation

The data center should record software costs as intangible assets and should allocate those costs to expenses over the periods that it expects to use the software to generate revenues.

Late Remittances to the State Treasurer's Office	Finding <p>The data center did not promptly remit monies to the State Treasurer's Office. We tested approximately \$66 million of the \$76 million that the data center remitted to the State Treasurer's Office during fiscal year 1990-91. Of this amount, the data center remitted approximately \$49 million from 2 to 28 days later than required by the State Administrative Manual. When the data center does not remit monies belonging to the revolving fund promptly to the State Treasurer's Office, these monies will be credited to the State's General Fund and will not be available for the revolving fund's use. To earn interest income for the revolving fund, the State Treasurer's Office, on order of the State Controller's Office, invests monies of the revolving fund in excess of immediate needs in the Surplus Money Investment Fund. Because the data center was late in remitting these monies to the State Treasurer's Office, we estimate that the State's General Fund earned approximately \$149,000 in interest income during fiscal year 1990-91 that the data center's revolving fund should have earned. We reported a similar weakness during our financial audit for fiscal years 1988-89 and 1989-90.</p>
Weakness in Control Over Salary Advances	Criteria <p>The State Administrative Manual, Section 8091, requires that when an agency accumulates deposits of \$25,000 or more, the agency must remit the money to the State Treasurer's Office no later than the first day of the week following the accumulation of that amount.</p> Recommendation <p>The data center should promptly remit amounts to the State Treasurer's Office in accordance with the State Administrative Manual.</p>

June 30, 1990. Failure to collect advances from employees may result in the loss of state funds if the employees leave state service without repaying the advances. In addition, the office revolving fund monies are not available for other uses when the advances are not promptly collected. We reported a similar weakness during our financial audit for fiscal year 1989-90.

Criteria

The State Administrative Manual, Section 8776.7, requires reimbursement to the State of salary advances made to employees. The manual suggests several procedures including the collection of salary advances from state employees from the subsequently issued payroll warrant for the period covered by the advance.

Recommendation

The data center should implement procedures to collect all outstanding advances.

Insufficient Documentation of Review of Bank Reconciliations

Finding

During our review of the data center's bank reconciliations for fiscal year 1990-91, we noted that the data center does not ensure that the preparer and the reviewer of its bank reconciliations sign and date them. Specifically, we found seven reconciliations without the signature of the preparer and four reconciliations without the signature of the reviewer. We also noticed that the data center did not date all of its bank reconciliations. As a result, we were unable to determine whether the data center prepared all of its bank reconciliations for fiscal year 1990-91 promptly. Also, the board cannot ensure that its bank reconciliations are reviewed. Bank reconciliations provide the data center assurance that errors or irregularities may be detected and corrected promptly. Because of the weaknesses in the bank reconciliation process and because of inadequate separation of duties reported in Item 4, the data center's management controls over cash may have been significantly impaired.

Criteria

The State Administrative Manual, Section 7908, requires agencies to show the dates all reconciliations were prepared and reviewed and the names of the preparers and reviewers in all of their reconciliations. In addition, the State Administrative Manual, Section 7900, requires agencies to prepare all reconciliations monthly within 30 days of the preceding month.

Recommendation

The data center should require its employees who prepare and review bank reconciliations to sign and date them.

Department of Transportation

We reviewed the financial operations and related internal controls of the Department of Transportation (department) and the department's administration of the U.S. Department of Transportation grant, Federal Catalog Number 20.205.

Federal Reimbursements for Contract Retentions Not Billed Promptly

Finding

The department did not promptly bill the Federal Highway Administration (FHWA) for the FHWA's share of certain costs for construction projects. The department withholds a portion of progress payments owed to contractors for construction projects to ensure the contractors satisfactorily complete the projects. The department releases these withholdings, referred to as contract retentions, to the contractors when the contractors satisfactorily complete the projects. The department can bill the federal government for the amount of the contract retentions only after it releases the contract retentions to the contractors. However, we found that the department did not always promptly bill the federal government after it released contract retentions. Specifically, the department did not promptly bill the federal government for approximately \$5.2 million in contract retentions for 23 projects.

According to the department, the method used to set up certain contracts in its construction contract payment system was incorrect, resulting in the delayed billings. During February 1992, the department implemented a new method to set up these contracts in its system, and this new method was designed to prevent the delayed billings. According to the department, it will also monitor the contract retentions to ensure it promptly bills for them. When the department does not promptly bill the federal government, it loses interest earnings. We estimate that the department lost approximately \$217,000 in interest because it did not promptly bill the federal government for the \$5.2 million in contract retentions.

Criteria

The department's Accounting Manual, Chapter 10, states that when the department releases contract retentions to the contractor,

it should process the amount of the contract retention for billing to the FHWA. In addition, the State Administrative Manual, Section 0911.4, requires state agencies to bill the federal government promptly.

Recommendation

The department should ensure that contract retentions are correctly set up in its construction contract payment system and continue to monitor contract retentions to ensure they are promptly billed.

Some Federal Reimbursements Not Promptly Requested at Highest Rates Allowed or at Correct Reimbursement Rates

Findings

Of 86 transactions eligible for federal reimbursement that we reviewed for fiscal year 1990-91, we noted four instances where the department did not promptly request reimbursements for federal aid projects at the highest rate allowed by the federal government or did not request reimbursements at the correct reimbursement rate. These instances occurred because new policies had not yet been issued or because of employee oversight or clerical errors. Specifically, we found the following:

- The department did not promptly adjust its reimbursement rate to reflect the highest rate allowed by the federal government for a federal aid project we reviewed at the Marysville district office. We noted that, for the project, the FHWA approved a rate increase during May 1987. However, the department did not revise its rates to reflect the increase until February 1992. As a result the department did not promptly request reimbursement from the FHWA of approximately \$3,534.

We identified a similar finding in our management letter (W-266), dated February 22, 1991. We reported that the department did not have a written policy directing staff to revise the rates. We recommended that the department develop a written policy to ensure that staff promptly request reimbursement for federal aid projects at the highest reimbursement rate allowed by the federal government. On June 28, 1991, the department issued a memorandum declaring it to be the policy of the department to promptly request

reimbursements for federal aid projects at the highest reimbursement rate allowed by the federal government.

- For a project we reviewed at the San Francisco district office, the department increased the reimbursement rate, but, because of an employee's oversight, did not promptly make a retroactive adjustment. As a result, the department did not promptly request reimbursement from the FHWA for \$1,783.
- For a federal aid project we reviewed at the department's headquarters, the department, because of a clerical error, used the incorrect federal participation percentage to set up the project in its federal billing system. As a result, the department underbilled the federal government for \$18,687 in project costs.
- For a project we reviewed at the San Diego district office, the department, because of a clerical error, adjusted its reimbursement rate to a higher rate than that allowed by the federal government without FHWA approval. As a result, the department overbilled the FHWA for \$721.

After we informed the department, the department corrected these errors.

Criteria

An FHWA notice, dated March 27, 1989, requires that the reimbursement rates initially agreed upon by the FHWA and the State be retained throughout the life of the project, except that the State may choose to revise rates for active projects by amending agreements between the FHWA and the State. In addition, the State Administrative Manual, Section 0911.4, requires state agencies to secure prompt reimbursement from federal grant funds for goods and services provided.

Recommendation

The department should ensure that it promptly requests reimbursement for federal aid projects at the highest rates allowed by the federal government. In addition, the department should ensure it uses the correct reimbursement rate.

Final Claims Not Filed Promptly	Finding The department did not promptly submit some final claims to the FHWA to close completed federal aid projects. In August 1987, the department and the FHWA agreed that the department should submit the final claim for a project within 24 months of project completion. For 3 of the 17 federal aid projects completed after August 1987 that we reviewed, the department did not submit the final claim within 24 months of project completion. These 3 final claims were submitted 30, 33, and 37 months after project completion and totaled \$1,890,167. Although the department generally receives reimbursement for eligible project costs before it submits the final claim, the FHWA will not consider a project closed until it reviews and approves a final claim. Moreover, until the project is closed, the department cannot reallocate the balance of authorized funds from the completed projects to other projects.
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Criteria

The Federal Aid Highway Program Manual, Volume 1, Chapter 4, Section 6, requires federal aid recipients to submit final claims promptly to the FHWA when the recipients complete projects. In addition, the department and the FHWA agreed the department should submit the final claim for a project within 24 months of project completion.

Recommendation

The department should submit final claims promptly to close completed federal aid projects.

Expenditure Reports Not Submitted Promptly	Finding Several of the department's district offices that we reviewed for fiscal year 1990-91 did not submit either preliminary or final expenditure reports for some completed construction projects to the department's headquarters by the required deadlines. Specifically, we found that, for 25 of the 120 projects completed during the year at the Marysville, Los Angeles, and San Diego district offices, the district offices had not prepared preliminary or final expenditure
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reports within 120 days of completing the project, as required by the department's Accounting Manual. The department cannot submit final claims to the FHWA for project costs until the district offices submit the preliminary or final expenditure reports. Furthermore, until the FHWA reviews and approves a preliminary or final claim, the department cannot reallocate the unused portion of the authorized funds from the completed project to other projects.

We identified a similar weakness during our financial audits for fiscal years 1988-89 and 1989-90 and recommended that the department's district offices complete and submit the reports within 120 days of a project's completion. On March 27, 1991, the department issued a memorandum describing procedures for staff of the department's headquarters and district offices to work together to identify the dates on which the reports are due to headquarters and to take the necessary steps to complete and submit the reports promptly. For May to June 1991, we did not identify any delinquent preliminary or final reports of expenditures.

Criteria

The Code of Federal Regulations, Title 23, Section 140.107, requires the department to promptly submit its request for reimbursement for a project after the project is completed. Additionally, the department's Accounting Manual, Chapter 8, states that the district offices should submit the final expenditure report to the department's headquarters within 120 days of a project's completion.

Recommendation

The department should continue monitoring expenditure reports to ensure the district offices continue to complete and submit either the preliminary or the final expenditure report within 120 days of a project's completion.

**Receipt of
Less Than Fair
Market Value
for Rented
Airspace**

Finding

The department is not receiving the fair market value for the rent of property located beneath a freeway. Such property is referred to as airspace. The department entered into an agreement in 1977 with the Department of General Services (DGS) for the DGS to rent airspace beneath a freeway for state employee parking. That lease expired in 1988. Negotiations for renewing the lease have been ongoing since 1987. However, the department and the DGS have not successfully renegotiated the amount of rent the DGS will pay for the airspace. The department has determined the fair market value for rental of the airspace to be \$15,400 per month. However, the DGS continues to use the property and continues to pay only \$2,950 per month, the rate in effect at the end of the lease. Because the department is receiving less than the fair market value for the airspace, it cannot use the amount of the full fair market value for federal aid highway projects, as required by federal law.

Criteria

The United States Code, Title 23, Section 156, requires states to charge, as a minimum, fair market value, for the sale, use, lease, or lease renewals of airspace acquired as a result of a project funded in whole or in part with federal assistance. Further, the section requires states to use revenues received from such sales or leases for federal aid highway projects.

Recommendation

The department should take steps to ensure that it receives the fair market value rate for the airspace it leases to the DGS.

**Late Transfer
Notices**

Finding

The department did not provide timely information to the State Controller's Office (SCO) for the SCO's transfers of fuel tax revenues to the Off-Highway Vehicle Fund and the Conservation and Enforcement Services Account. The department is responsible for estimating the amount to transfer and sending transfer notices to the SCO so the SCO can transfer fuel tax revenues promptly. Eleven of the 12 monthly transfer notices for fiscal year 1990-91

that the department provided to the SCO were not provided by the first day of the month, the day on which the SCO is required to transfer the revenues. In addition, we noted that the first 6 monthly transfer notices for fiscal year 1991-92 were also late. The 17 transfer notices for both years were from 7 to 165 days late. Failure by the department to provide timely information to the SCO results in the unavailability of fuel tax revenues for their intended use.

Criteria

The Revenue and Taxation Code, Sections 8352.7 and 8352.8, requires that, on the first day of every month, the SCO transfer fuel tax revenue to the Off-Highway Vehicle Fund and the Conservation and Enforcement Services Account based on an estimate prepared by the department in cooperation with the Department of Parks and Recreation.

Recommendation

The department should provide the SCO with timely monthly transfer notices to enable the SCO to transfer fuel tax revenues to the Off-Highway Vehicle Fund and the Conservation and Enforcement Services Account.

Noncompliance With Federal and State Requirements

Findings and Criteria

In the following instances, the department did not always comply with the administrative requirements of the federal government and the State:

- The department's headquarters did not always prepare reconciliations of its Centralized State Treasury System (CTS) accounts within 30 days of the end of the month. We reviewed the department's monthly reconciliations of three CTS accounts for fiscal year 1990-91 and found the department prepared 4 of the 36 reconciliations from one to 17 days late. The State Administrative Manual, Section 8060, requires the department to reconcile all CTS accounts at the end of each month.

Further, Section 7900 requires the department to prepare reconciliations within 30 days after the end of the preceding month.

- Of the 30 cash receipts we reviewed at the department's headquarters, the department deposited two receipts totaling \$101,839 one day late. We observed a similar condition during our financial audit for fiscal year 1989-90. The State Administrative Manual, Section 8030.1, stipulates that agencies deposit collections of more than \$5,000 on the day they are received unless they are received late in the day.
- During our review of payroll transactions at the Los Angeles district office, we found that an employee of the department authorized his own daily attendance report, thereby authorizing his own overtime. The State Administrative Manual, Section 8539, states that employees cannot certify their own attendance reports.
- During our review of right-of-way transactions at the Marysville district office, we found that the district did not have adequate procedures to prevent duplicate payments for right-of-way property acquisitions and relocation assistance. The State Administrative Manual, Section 8422.1, requires agencies to determine that payment has not previously been made before submitting claims to the SCO for payment.
- In our review of 33 expenditure transactions at the San Diego district office, we found that one payment was made before service had been completed. In addition, the invoice was not authorized for payment by a department officer. Furthermore, the district paid this vendor a total of \$1,232 for recurring services without a contractual agreement between the district office and the vendor. Payment for goods or services without evidence of authorization, before services are completed, or without a contractual agreement can result in the loss of state funds. The State Administrative Manual, Section 8422.1, requires evidence that items invoiced have been received and that authority exists to obtain the services before state agencies

submit claims to the SCO for payment. In addition, the department's Accounting Manual requires services for more than \$50 to be under contract.

- The department's headquarters did not request reimbursement for a payment of \$1,982 on a federal aid project. The department incorrectly determined the payment was ineligible for federal reimbursement because the department believed it made the payment before the Federal Highway Administration (FHWA) authorized the federal aid project. However, we determined the department made the payment after the FHWA authorized the project, and therefore, the payment was eligible for federal reimbursement. The State Administrative Manual, Section 0911.4, requires state agencies to secure reimbursement from the federal government for goods and services provided under federal programs.
- The San Diego district office did not reimburse the FHWA for monies the department owed to the FHWA. The department disposed of a right-of-way property it had acquired, in part, with FHWA funds. However, the department did not reimburse the FHWA the \$2,000 that represented the FHWA's share of proceeds from the disposition. The Code of Federal Regulations, Title 23, Section 713.307, requires the department to reimburse the FHWA for the FHWA's share of proceeds from the disposition of right-of-way property.

Although individually these instances of noncompliance may appear insignificant, any deviations from the State's system of internal controls or noncompliance with federal regulations makes the public's resources vulnerable to abuse.

Recommendation

The department should improve its compliance with each of the federal and state requirements.

Education

California Community Colleges, Chancellor's Office

We reviewed the financial operations and related internal controls of the California Community Colleges, Chancellor's Office, (Chancellor's Office) and the Chancellor's Office's administration of the U.S. Department of Education grant, Federal Catalog Number 84.048, and the U.S. Department of Health and Human Services grant, Federal Catalog Number 83.025.

Improvements Needed Over Cash Management

Finding

The Chancellor's Office did not always properly control the system for managing its federal vocational education funds. The Chancellor's Office acts as an intermediary in the allocation of these funds between the California Department of Education (CDE) and subrecipient organizations, including community college districts. Each fiscal year, the Chancellor's Office contracts with the CDE for the Chancellor's Office's share of the federal vocational education funds. It requests cash advances of its federal vocational education funds from the CDE and then disburses the funds to the subrecipients. During our audit, we noted the following conditions for the Chancellor's Office's three active vocational education contracts:

- The Chancellor's Office did not limit its cash advances to the immediate needs of the subrecipient organizations during January, February, and March 1991. For example, on January 3, 1991, the Chancellor's Office had approximately \$15.1 million in excess cash advances from its contracts with the CDE. The Chancellor's Office disbursed these excess funds by January 25, 1991. In another instance, on February 22, 1991, the Chancellor's Office had approximately \$695,000 in excess cash advances. The Chancellor's Office disbursed these excess funds by March 6, 1991. Some of this delay can be attributed to the time the State Controller's Office takes to process the disbursements.

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- During the rest of fiscal year 1990-91, the Chancellor's Office did not ensure that it had received the federal vocational education funds from the CDE before making disbursements to the subrecipients or that it promptly requested reimbursement for administrative costs. For example, the Chancellor's Office requested reimbursement for 11 claim schedules totaling \$223,000 at least eight months after the claim schedules had been paid. In another instance, the Chancellor's Office billed the CDE for \$12,600 in administrative costs eight months after the costs had been incurred.

We estimate that as a net result of these two conditions during the fiscal year 1990-91, the State lost potential interest earnings of \$104,000. We reported similar weaknesses in our audits of the last four fiscal years.

Criteria

The Code of Federal Regulations, Title 31, Section 205.4(a), requires that cash advances be limited to the minimum amounts needed and timed to be in accord with the actual and immediate cash requirements of the funded programs. This section also stipulates that the timing and amount of cash advances be as close as administratively feasible to the actual disbursement by the recipient organization. In addition, the State Administrative Manual, Section 0911.4, requires state agencies to secure prompt reimbursement from grant funds for goods and services provided.

Recommendation

The Chancellor's Office should control its system for managing its federal vocational education funds to ensure that it promptly requests reimbursements of federal funds while also avoiding excess cash balances.

Errors in Apportionment Payments

Finding

During fiscal year 1990-91, the Chancellor's Office made several errors in calculating and documenting apportionment payments. During our audit, we noted the following conditions:

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- The Chancellor's Office did not allocate all the available money using its formula to calculate allocations for the Disabled Student Programs and Services (DSP&S) program. The amount available for allocation to individual campuses for DSP&S should have been the total appropriation for fiscal year 1990-91, adjusted for certain factors. However, the Chancellor's Office based its allocation on the prior year's apportionment total because the fiscal year 1990-91 appropriation had not been finalized at the time the Chancellor's Office first calculated the DSP&S allocation for fiscal year 1990-91. Although the actual appropriation for fiscal year 1990-91 was available in February 1991 when the Chancellor's Office recalculated all allocations with more current information, the Chancellor's Office did not use the actual DSP&S appropriation in its recalculation. Consequently, the Chancellor's Office should have allocated \$408,527 more to individual college campuses than it did. The Chancellor's Office subsequently allocated this money in the reallocation process in June 1991, but it did so only to colleges requesting additional funds rather than to all 106 college campuses. As a result, some colleges may not have received all of the funds they were entitled to receive. If the allocation is incorrect in one year, it affects the base used in calculating subsequent years' allocations.
 - The Chancellor's Office incorrectly calculated the allocations to college campuses for the DSP&S program. Specifically, the Chancellor's Office did not include all operational expenses for instructional administration in the calculation of the college effort component of the allocation. According to the Dean of Student Services for the DSP&S unit, these costs should have been included. Because of limitations built into the formula, this error did not affect all of the DSP&S program allocations. For example, for the four districts we reviewed, the inclusion of the costs would have reduced the allocations to two districts by minor amounts, but would not have changed the allocations to the other two districts. According to the Dean of Student Services for the DSP&S unit, the Chancellor's Office has corrected the formula for the fiscal year 1990-91 recalculation and for the fiscal year 1991-92 allocation.

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- The Chancellor's Office did not retain the supporting documentation needed to determine whether the Matriculation allocation to individual colleges was correctly calculated. Specifically, we could not determine the correct student counts for seven colleges. Although we determined that the total apportionment for Matriculation was correct, we could not determine if the apportionments to individual campuses were correct. According to the Dean of Student Services for the Matriculation unit, the data files containing the supporting documentation were accidentally deleted and the backup files were deleted after three months. The Chancellor's Office is now maintaining a backup file in the Matriculation unit.

Criteria

The California Education Code, Section 84850, requires the Board of Governors of the California Community Colleges to adopt rules and regulations for the administration and funding of educational programs and support services to be provided to disabled students by community college districts. The DSP&S funding formula approved by the Board of Governors stipulates that new funds allocated to DSP&S should be distributed through the formula. In addition, the DSP&S funding formula specifies the elements that are to be included in the calculation of the college effort element of the DSP&S allocation. Further, the California Government Code, Section 13402, requires agencies to maintain an effective system of internal accounting and administrative control. The Government Code, Section 13403, requires that the system of internal control include a system of recordkeeping procedures to provide effective accounting control over revenues and expenditures. Finally, the State Administrative Manual, Section 1667, requires agencies to consider audit requirements when making decisions for document retention periods.

Recommendation

The Chancellor's Office should ensure that the DSP&S apportionment includes all available funds. In addition, the Chancellor's Office should ensure that all applicable costs are included in the calculation of the apportionment formula. Finally,

the Chancellor's Office should ensure that records supporting the calculation of apportionments are maintained at least until an audit is completed.

**Lack of
Control Over
Disbursements**

Finding

The Chancellor's Office lacks controls over its disbursements. During our audit, we noted the following deficiencies:

- Purchase documents do not always contain evidence that the Chancellor's Office has verified the receipt of billed goods or services. In our review of 97 claims transactions, we found one transaction totaling approximately \$1,600 that lacked evidence that the Chancellor's Office had received the billed goods or services before paying for them. We reported a similar weakness in our financial audits of the last four fiscal years.
- The Chancellor's Office does not always ensure that expenditures have proper authorization before payment. For 9 of the 97 claims transactions that we tested, the Chancellor's Office paid approximately \$2,100 without evidence of proper approvals. Specifically, the Chancellor's Office paid for furniture rental even though the period during which the furniture was used was not covered by a valid purchase order. In addition, the Chancellor's Office paid for travel costs for which it was not able to provide evidence that the travel was approved. If proper authorization is not obtained, the Chancellor's Office is not always assured that all of its expenditures are appropriate.

Criteria

The State Administrative Manual, Section 8422.1, requires agencies to determine that invoiced items, including items covered by travel vouchers, were received and that authority existed to obtain the item.

Recommendation

The Chancellor's Office should ensure that someone verify the receipt of goods and services before paying for them and that its purchasing procedures comply with state requirements. In addition, the Chancellor's Office should ensure that travel expenditures have been properly authorized before payment is made.

Late Remittances to the State Treasurer's Office

Finding

The Chancellor's Office did not promptly remit money to the State Treasurer's Office. We tested all remittances greater than \$100,000 that the Chancellor's Office remitted to the State Treasurer's Office during fiscal year 1990-91. Of the \$34.1 million that we tested, the Chancellor's Office remitted \$2.8 million from one to 11 days later than required by the State Administrative Manual. The Chancellor's Office was 203 days late in remitting an additional \$500,000. When the Chancellor's Office does not remit the money promptly to the State Treasurer's Office, this money will not be recorded to the proper fund and, therefore, will not be available for its intended purpose. We reported a similar weakness in our financial audits for fiscal years 1986-87, 1987-88, and 1989-90. In its response to our fiscal year 1989-90 management letter, the Chancellor's Office stated that its current procedures require remittances to the State Treasurer's Office within one week unless the amount requires an earlier remittance. In our testing, we noted that the Chancellor's Office was late in remitting only one of the five remittances that occurred after the date of our fiscal year 1989-90 management letter.

Criteria

The State Administrative Manual, Section 8091, requires that when an agency accumulates deposits of \$25,000 or more, the agency must remit the money to the State Treasurer's Office no later than the first day of the week following the accumulation of that amount.

Recommendation

The Chancellor's Office should promptly remit amounts to the State Treasurer's Office in accordance with the State Administrative Manual.

Weaknesses in Control Over the Revolving Fund

Finding

The Chancellor's Office does not properly maintain its listing of expense, travel, and salary advances made from the revolving fund. During our review of the June 30, 1991, listing, we noted that several items totaling \$16,177 had been outstanding for more than one year. Because of insufficient documentation, we were unable to verify whether the Chancellor's Office could collect the long-outstanding advances. We reported a similar weakness in fiscal years 1988-89 and 1989-90. The accounting administrator acknowledged that the listing of advances made from the revolving fund was not accurate. According to the administrator, several errors made during the past years have never been researched, and many of the errors cannot be resolved because of a lack of supporting documentation. Although in response to each of our prior audits the Chancellor's Office stated that it would file a Board of Control claim for the uncollectible amount, as of May 19, 1992, it had filed no such claim.

Criteria

The State Administrative Manual, Sections 8190 and 8192, requires state agencies to maintain a listing of advances made from the revolving fund to account for all the fund's transactions. In addition, the State Administrative Manual, Section 8116, requires agencies to reimburse and, therefore, clear advances from the records when employees submit their travel expense claims. Finally, the State Administrative Manual, Section 8595, states that agencies will collect salary advance repayments from the subsequently issued payroll warrants for the periods covered by the salary advances.

Recommendation

The Chancellor's Office should properly maintain the listing of advances made from the revolving fund and implement procedures to collect all long-outstanding advances or should file a claim for uncollectible amounts.

Accounting Transactions Insufficiently Documented

Finding

The Chancellor's Office was unable to identify or document and therefore could not resolve four long-outstanding reconciling items, totaling approximately \$10,600, that were included on the June 30, 1991, reconciliation of its general checking account. We reported a similar weakness in our financial audits for the last five fiscal years. Although the Chancellor's Office has significantly reduced the amount of its reconciling items between March 31, 1990, and June 30, 1991, it continues to carry reconciling items on the reconciliation of its general checking account for which the underlying transaction is not documented. Failure to clear these reconciling items may result in the Chancellor's Office not promptly detecting errors or irregularities, such as unauthorized cash disbursements or failure to deposit money.

Criteria

The State Administrative Manual, Section 7967, requires that an explanation of the nature of every unusual reconciling item be made a part of the monthly bank reconciliation. It also requires that the person reconciling the bank statement trace every unusual reconciling item to identify its nature.

Recommendation

The Chancellor's Office should identify and support all accounting transactions it makes in its accounting records. Further it should resolve all reconciling items in its general checking account.

Weak Internal Controls Over Property

Finding

The Chancellor's Office has not reconciled its physical inventory of property with its accounting records for the last nine years. If the Chancellor's Office does not reconcile the physical property counts with the accounting records, it may not detect the loss or theft of state property. In response to our report for fiscal year 1989-90, the Chancellor's Office stated that its inventory of property, begun in September 1990, was 95 percent complete. The inventory of property was completed as of June 1, 1991, but the Chancellor's Office had not yet reconciled the physical property counts to the accounting records.

Criteria

The State Administrative Manual, Section 8652, requires that agencies reconcile the physical property counts with the accounting records at least once every three years.

Recommendation

The Chancellor's Office should reconcile the physical property counts with the accounting records as required.

Noncompliance With Certain State Requirements

Findings and Criteria

In the following instances, the Chancellor's Office did not comply with administrative requirements of the State:

- The Chancellor's Office did not promptly deposit all of its collections. Of the 15 cash deposits we reviewed, the Chancellor's Office did not deposit 2 accumulated cash receipts of \$7,101 and \$12,713 within one working day as required by the State Administrative Manual. The deposits were deposited two days and one day late, respectively. Failure to promptly deposit collections results in a loss of interest income to the State. The State Administrative Manual, Section 8030.1, requires agencies to deposit collections totaling more than \$5,000 on the day that they are received unless they are received late in the day or another reason prevents their deposit.

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- For five of the ten nonconsulting contracts that we reviewed, we found that the contractors began contract work before the Department of General Services or an agency-designated person had approved the contracts. If the Department of General Services or the Chancellor's Office had not approved these contracts, the State might still have been liable for the work performed and might have incurred litigation costs regarding the State's obligation to pay for that work. The State Administrative Manual, Section 1209, requires departments to submit each contract in time for the Department of General Services to approve the contract before work commences.
 - The Chancellor's Office does not adequately separate duties for the recording and disbursing of cash. One employee who receives and deposits remittances also initially records transactions in the cash disbursements register. Another employee prepares checks and mails or distributes those checks. The State Administrative Manual, Section 8080, recommends that the person receiving and depositing remittances not keep any books of original entry concerning cash. This section also prohibits an employee who prepares checks from mailing those checks.

Recommendation

The Chancellor's Office should improve its compliance with each of the state requirements.

California School for the Deaf, Northern California

We reviewed the financial operations and related internal controls of the California School for the Deaf, Northern California (school) and the school's administration of the U.S. Department of Agriculture grants, Federal Catalog Numbers 10.553 and 10.555, and the U.S. Department of Education grants, Federal Catalog Numbers 84.010, 84.048, and 84.151.

Weaknesses in Control Over the Student Work Experience Program

Finding

The school has weaknesses in its control of its student work experience program. The school's Endowment Fund, which funds the student work experience program, provided approximately \$13,000 in fiscal year 1989-90 for the program. We noted the following specific weaknesses:

- The school used an inadequate method to record cash payments to students for work performed in the student work experience program. When the career center coordinator presented an approved voucher for reimbursement of program costs, the accounting officer issued an endowment fund check payable to her. She stated that she had disbursed cash to the students and maintained disbursement records. The students signed a record acknowledging receipt of the cash, but the records do not indicate that the cash was for specific hours of work performed in the student work experience program. Some of the disbursement records were not dated and none of the records reviewed could be traced directly to the reimbursement vouchers. Thus, the school did not demonstrate that the students were paid for actual work performed or that they were paid appropriately or promptly.
- The career center coordinator did not always promptly submit vouchers for reimbursement of student work experience payments to students. Between June 26, 1990, and June 29, 1990, the coordinator submitted five work experience vouchers for student work performed in March through

June 1990 to the school's Endowment Fund approval committee. The accounting officer issued a check for \$8,064 on June 29, 1990, payable to the coordinator, who stated that sometimes she used her personal funds to pay the students at the end of each work period and then reimbursed herself from the Endowment Fund.

- The school did not use written agreements with private businesses that accept students for employment training to identify the conditions of employment. Specifically, the school did not identify the wage to be earned nor did it clearly state that the Endowment Fund would pay the student. Although the school maintains student case notes addressing some of this information, the lack of written agreements with private businesses that employ students creates the possibility of errors or irregularities.

Criteria

The California Government Code, Sections 13402 and 13403, require agency heads to ensure that a satisfactory system of internal accounting and administrative controls is in place to provide effective accounting control over assets, liabilities, revenues, and expenditures.

Recommendations

The career center coordinator should promptly submit claims for reimbursement to eliminate the use of her personal funds in meeting authorized obligations and to ensure the prompt recording of expenditures. To document cash payments to students, the school should ensure that it maintains adequate records showing specific hours worked, on which days, and at what rate. The school should also prepare written agreements with private businesses to clarify the conditions of employment.

The internal audit unit of the California Department of Education should further review this program's cash payments.

Weaknesses in Control Over Cash	Finding
	<p>The school has weaknesses in its control over the cash account. We noted the following specific conditions:</p> <ul style="list-style-type: none"> • The school did not maintain appropriate separation of duties. The employee who deposited remittances also recorded transactions in the revolving fund and endowment fund cash books and prepared the monthly bank and revolving fund reconciliations. Failure to adequately separate accounting duties can result in errors, irregularities, or illegal acts that may go undetected for extended periods. • The cash balance on the June 30, 1990, analysis and reconciliation of revolving fund accountability did not agree with the monthly bank reconciliation. In addition, the general cash and revolving fund cash balances on the year end bank reconciliation did not agree with amounts reported on the Pre-Closing Trial Balance. As a result, the State Controller's Office may not have had accurate information to prepare the State's financial statements. • One deposit of nearly \$15,000, made in April 1990, remained in transit as of the March 1991 bank reconciliation. The school did not determine why this deposit had not been credited to its account until we questioned school staff in April 1991. By not determining why the school had not received credit for its deposit, school staff could not be assured that the school would receive the appropriate credit.

Criteria

The State Administrative Manual, Section 8080, prescribes that no one person will deposit remittances and reconcile bank accounts or post any subsidiary ledger affected by cash transactions.

The State Administrative Manual, Section 7900, indicates that the accuracy of an agency's accounting records may be partially proved by making certain reconciliations. The State Administrative Manual, Section 7920, states that one type of reconciliation agencies perform is that of two or more accounts with each other or with other records kept by an agency.

The California Government Code, Sections 13402 and 13403, require agency heads to establish and maintain a system or systems of internal accounting and administrative controls. Among the elements of the control systems are the measures adopted to safeguard assets and check the accuracy and reliability of accounting data.

Recommendation

The school should separate its accounting duties to comply with the requirements in the State Administrative Manual. The school should prepare and review reconciliations in a manner that allows for detection and correction of errors before financial statements are prepared. In addition, the school should promptly follow up on deposits not credited to its account.

Amounts Owed to the School Not Promptly Cleared or Collected

Finding

The school did not promptly clear revolving fund salary advances or collect amounts owed from employees. We noted the following specific conditions:

- At June 30, 1990, approximately \$10,000 (80 percent) of the nearly \$12,500 salary advances in the revolving fund was outstanding for more than 30 days. Salary advances outstanding for more than 90 days amounted to approximately \$8,200 (66 percent) of the June 30, 1990, outstanding salary advance balance.
- The school did not have a record of collection efforts for three payroll receivables totalling nearly \$5,000. These payroll receivables were 73 percent of the balance in the accounts receivable - abatements account at June 30, 1990.

Failure to collect advances from employees may result in the loss of state funds if the employees leave state service without repaying the advances. In addition, office revolving funds are not available for other uses when the school does not promptly collect advances.

Criteria

For the fiscal year audited, the State Administrative Manual, Section 8118, required the school to collect the salary advance repayment from the subsequently issued payroll warrant for the period covered by the salary advance. In addition, the State Administrative Manual, Section 8776.55, required the accounting office to send a request for payment to current and separated employees when a payroll receivable was established and to perform additional collection procedures as needed.

Recommendation

The school should implement procedures to clear and collect all outstanding amounts due to the school.

California State University

We reviewed the financial operations and related internal controls of the California State University (CSU) at three campuses.

Weak Controls Over Purchasing

Finding

CSU San Francisco, CSU Sonoma, and CSU San Jose did not always provide adequate control over purchasing. We noted the following specific examples:

- CSU Sonoma did not prepare purchase or service orders for 2 of the 30 items reviewed until after the goods or services had been received. Additionally, for one of the 30 items reviewed, CSU Sonoma paid a vendor for 6 articles although the university had received only 4.
- CSU San Francisco did not always cancel supporting documents to indicate payment and thereby preclude their reuse. In our review of 30 disbursements made at CSU San Francisco, we noted ten instances where the supporting documents had not been cancelled.
- CSU San Jose made two payments to the same vendor for the same service.
- In addition, CSU Sonoma and CSU San Jose did not always determine that goods or services were received before they paid invoices. Specifically, CSU Sonoma and CSU San Jose did not always have a signature or stamp on the receiving department's copy of the purchase order to provide evidence that the goods or services listed on the purchase order had actually been received. In our review of 30 items each at CSU Sonoma and CSU San Jose, we noted two instances at CSU Sonoma and ten instances at CSU San Jose where the receiving department's copy of the purchase order did not have a signature or stamp.

Criteria

The State Administrative Manual, Section 8422.1, states that, when making disbursements, the agency will determine that

1. Authority existed to obtain the goods or services.
2. Payment has not previously been made.
3. Items invoiced have been received, as evidenced by stock received reports.
4. Invoices comply with the provisions of the purchase orders.

Recommendation

CSU San Francisco, CSU Sonoma, and CSU San Jose should follow the state requirements and good business practices for procuring goods and services.

Weakness in Separation of Duties

Finding

At CSU San Francisco, the accounts payable supervisor with authority to authorize disbursements also had authority to operate the check signing machine and had access to the blank check stock. This employee had recently been promoted to accounts payable supervisor, and at the time of our review the employee's name had not been removed from the list of people authorized to operate the check signing machine and have access to the blank check stock.

Without the proper separation of duties, errors and irregularities may go undetected and management might not be able to determine the responsibility for errors and irregularities.

Criteria

The State Administrative Manual, Section 8080, specifies that an employee who authorizes disbursements should not operate a check signing machine. In addition, an employee who operates a check signing machine should not have access to or control of blank check stock.

**Noncompliance
With Certain
State
Requirements**

Recommendation

CSU San Francisco should remove the employee's name from the list of those people authorized to operate the check signing machine, and ensure that the employee does not have access to the blank check stock.

Findings and Criteria

We noted the following instances where the campuses did not always comply with administrative requirements of the State:

- CSU Sonoma used its revolving fund to pay an invoice that should have been paid through the State Controller's Office by claim schedule. The State Administrative Manual, Section 8110, states that revolving funds are used for compensation earned, travel expenses or advances, or where immediate payment is necessary. This payment did not meet any of the conditions for revolving fund use.
- A CSU San Francisco employee purchased items without specific approval for those items. The employee instead purchased other items that were not on the approved purchase order. The State Administrative Manual, Section 8422.1, limits purchases to approved items.
- CSU San Jose did not ensure that deposits in transit within the Centralized State Treasury System, totaling approximately \$140,000, were credited promptly to its checking account. These deposits were outstanding for periods ranging from ten months to one year. The State Administrative Manual, Section 8032.2, states that agencies must research deposits that do not equal the amounts shown on their report of deposits within 14 calendar days of the bank's notification.
- For 11 of 12 months in fiscal year 1990-91, CSU San Jose did not reconcile its bank accounts with its records within 30 days after the end of the preceding month as required by the State Administrative Manual, Section 7900.

Although individually these instances of noncompliance may not appear to be significant, they are deviations from state requirements, which are designed to ensure that the public's resources are not vulnerable to abuse.

Recommendation

The California State University campuses should improve their compliance with each of these state requirements.

California Student Aid Commission

We reviewed the California Student Aid Commission's (commission) administration of the U.S. Department of Education grant, Federal Catalog Number 84.032.

Failure To Ensure Adequate Collection Efforts on Defaulted Loans

Finding

The commission did not always ensure the adequacy of efforts to collect on defaulted student loans purchased by the commission. The commission is required to follow specified procedures when attempting to collect defaulted student loans that it has purchased. The commission's service contractor and various collection agencies perform these procedures. For 3 of 40 loans we reviewed, the commission's service contractor or the assigned collection agency did not perform at least one of the required procedures.

For one of the 3 loans that we identified as having insufficient collection procedures, the commission's service contractor did not make the required telephone attempts during the first 45 days of the collection period as required by federal regulations. Specifically, we found that the service contractor made two telephone attempts on the same day. In an October 4, 1990 letter to the Office of the Auditor General, the chief of the Guaranteed Student Loan Branch of the United States Department of Education official stated that the department interprets the requirements to indicate that the two telephone attempts must be made on different days as is also required for lenders before the commission purchases the loan.

For the remaining 2 loans that we identified as having insufficient collection procedures, the commission's assigned service agency did not send any collection letters during one of the subsequent periods, or begin procedures for locating borrowers within specified time limits as required by federal regulations.

Because the commission did not ensure that required collection procedures were followed, it could have been losing payments on defaulted loans. In addition, failure to follow federal requirements

for collections could jeopardize federal reimbursements and could result in the federal government taking action against the commission's administration of the federal Guaranteed Student Loans program. We observed a similar weakness in our audit for fiscal years 1988-89 and 1989-90.

Criteria

The Code of Federal Regulations, Title 34, Section 682.410(b)(4), requires the commission to engage in diligent collection efforts. These efforts include a specified number of telephone calls and letters in each predetermined collection period after the commission pays a default claim on a loan.

Recommendation

The commission should ensure that the required collection efforts are made on all defaulted student loans.

Failure To Ensure That Defaulted Student Loans Met Federal Reimbursement Requirements

Finding

The commission did not ensure that all of the defaulted student loans that it submitted for reimbursement to the federal government met federal requirements for reimbursement. Before the commission purchases defaulted student loans from lenders, it must ensure that the lenders meet the federal requirements for submitting default claims to the commission. Additionally, the commission must meet federal deadlines for paying lenders for defaulted loans and for requesting payment from the federal government. Of the 40 loans purchased by the commission that we reviewed, we found that 2 loans did not meet one of these federal requirements for reimbursements. We found the following specific problems:

- For one of the loans, the commission's service contractor accepted a default claim that the lender had submitted one day after the required 90-day deadline. We considered the date the default claim was received by the service contractor as the submission date because the postmark was not available. The commission's claim procedures manual provides that the date the default claim was received be used in this situation.

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- For one of the loans, the commission did not pay the lender within the required 90 days of the date that the lender submitted the default claim. Rather, it paid the lender 17 days after the required deadline. In our audits of the last three years, we also reported instances when the commission did not pay the lender within the required 90 days. Although we noted this problem again during this audit, the commission was late on a fewer number of loans than in the previous year.

Failure to ensure that loans meet federal requirements could jeopardize federal reimbursements.

Criteria

The Code of Federal Regulations, Title 34, Section 682.406(a), lists the conditions that must be met to qualify a defaulted student loan for federal reimbursement. These conditions include requirements that the lender submit a default claim within 90 days of default, and that the commission pay the lender within 90 days of the date the lender submitted the claim.

Recommendation

The commission should ensure that all defaulted student loans it submits for reimbursement to the federal government meet federal requirements.

Insufficient Procedures and Documentation To Ensure That Bankruptcy Claims Met Federal Reimbursement Requirements

Finding

The commission did not ensure that all bankruptcy claims that it purchased from lenders met federal requirements for reimbursement. A lender submits a bankruptcy claim to the commission for reimbursement if a borrower files a petition for relief of payment of a student loan with the bankruptcy court. If the student loan is discharged by the bankruptcy court, the commission submits a claim to the federal government for reimbursement. To be eligible for federal reimbursement, the commission must follow certain procedures before it pays the lender's bankruptcy claim. In our review of 20 lenders' bankruptcy claims, we found that in paying 7 of these bankruptcy claims, the commission did not follow one or more requirements for federal reimbursement.

Specifically, we found the following problems:

- For 4 loans, the commission paid approximately \$42,000 to lenders for bankruptcy claims lenders filed one, 4, 34, and 525 days after the required 30-day deadline. Although the lenders did not meet the 30-day deadline, the commission has received approximately \$5,000 in federal reimbursement.
- The commission improperly paid approximately \$2,900 for a lender's bankruptcy claim almost one year after the bankruptcy action had been dismissed by the court. As the bankruptcy action was dismissed, the lender should have kept the loan and the borrower should have continued repaying the lender.
- The commission did not provide us with sufficient evidence to demonstrate that all lenders promptly filed a proof of claim. Once a lender determines that a borrower has filed a bankruptcy petition, the lender must file a proof of claim against the borrower with the bankruptcy court within 30 days after the lender receives notice of the first meeting of creditors. For three loans, totaling approximately \$36,000, the commission did not provide us with evidence that the lenders' proofs of claim had been filed with the bankruptcy court. In addition, for two of these three loans, the commission did not provide us with evidence that the lenders transferred their proofs of claim to the commission. For another three loans, the commission did not provide us with evidence that the lenders' proofs of claim had been filed promptly because the commission's records did not show the bankruptcy court filing date.

Failure to ensure that the loans the commission purchases from lenders meet federal requirements could jeopardize federal reimbursement.

Criteria

The Code of Federal Regulations, Title 34, Section 682.402(e)(2)(ii), requires that, as a condition for obtaining payment, a lender must file a bankruptcy claim within 30 days after receiving notice of the first meeting of creditors.

The Code of Federal Regulations, Title 34, Section 682.402 (g) (1), requires that after payment of a bankruptcy claim to a lender, the commission shall diligently contest the discharge of the original loan by the bankruptcy court. If the loan is discharged, the commission must then submit the bankruptcy claim for reimbursement. If the loan is not discharged, the commission should require the lender that filed the claim to repurchase the loan or should permit another eligible lender to purchase the loan.

The Code of Federal Regulations, Title 34, Section 682.402(d)(3), requires that once a lender determines that a borrower has filed a bankruptcy petition, the lender shall file a proof of claim with the bankruptcy court within 30 days after the lender receives notice of the first meeting of creditors. The Code of Federal Regulations, Title 34, Section 682.402 (e) (1) (A), requires that a bankruptcy claim must include an assignment to the commission of the lender's proof of claim.

Recommendation

The commission should implement procedures and maintain sufficient documentation to ensure that bankruptcy claims meet federal reimbursement requirements.

Guaranteed Student Loans Exceeded Allowable Loan Limits

Finding

During the fiscal year 1990-91, the commission guaranteed individual student loans that exceeded allowable federal loan limits. The State reports that the commission guaranteed 341,354 loans during fiscal year 1990-91. We performed a computer search of the commission's borrower files for fiscal year 1990-91 to help identify individual loans guaranteed in excess of allowable federal loan limits. Federal regulations specify the maximum amount of a student's loans that can be guaranteed based on the student's grade level, the length of the course of study, and the total outstanding principal of all the student's loans.

As shown in the table, for the 68 borrower files that we selected for review following our computer search, the commission guaranteed loans that exceeded limits for 9 borrowers. The 9 loan guarantees

exceeded the limits by approximately \$24,000. Noncompliance with federal loan limits could result in a loss of state funds if the borrower defaults. If the borrower defaults, the federal government may not purchase from the commission the portion of defaulted loans above the limit.

Results of Loan-Limit Testing Fiscal Year 1990-91

Type of Loan/ Type of Limit	Potential Exceptions, Computer Identified	Potential Exceptions Reviewed	Guaranteed Loans Exceeding Limits	Loans for Which We Could Not Conclude
Stafford:				
Individual loan	2	2	1	0
Academic year	21	11	8	0
Cumulative	85	14	0	0
Supplemental Loans for Students and Parent Loan Program:				
Individual loan	28	3	0	0
Academic year	a	31	0	7
Cumulative	b	7	0	0
Total		68	9	7

^a The number of potential exceptions identified by the computer is misleading. The commission's computer file defined an academic year as 335 days. However, schools may measure the academic year differently depending on the type of academic program they administer.

^b The number of potential exceptions identified by the computer is misleading because our computer search did not recognize instances when a parent borrower's account included more than one student.

For 5 of the 9 loans, the commission manually combined two loan accounts into one account because information had previously been reported incorrectly under two account numbers. When the commission manually combines accounts, its computer system does not perform a subsequent review of the loan limits of the combined accounts. For an additional 2 of the 9 loans, the commission had incorrectly entered information into the system. For one of the 9 loans, the borrower received a guaranteed loan allegedly through an illegal practice. We could not determine why the commission guaranteed the remaining loan in excess of the limits.

We also could not determine whether 7 of the 41 borrowers of Supplemental Loans for Students (SLS) we reviewed exceeded the limit within a specified academic year because the schools the borrowers attended went out of business. Thus, we could not obtain all the information we needed to reach a conclusion.

We reported a similar weakness in our management letter for fiscal year 1989-90. In its response of March 4, 1991, the commission reported that at the time the loans were guaranteed they did not exceed the limit and properly passed through its system's editing process. Data to correct social security numbers, grade levels, or loan periods were later submitted by the school or lender. Because the loans had already been disbursed when the commission received corrected information, the commission does not require repayment of the loan until it can be determined who should be held responsible. The commission also reported that it would have its service contractor research the records of loans for which we could not determine the cause of the overpayment.

Criteria

The United States Code, Title 20, Sections 1078, 1078-1, and 1078-2, provide for specific loan limits for guaranteeing Stafford, SLS, and Parent Loan Program loans based on the student's grade level, the length of the course in which the student is enrolled, and the total outstanding principal for each loan program.

Recommendation

The commission should guarantee only loans that are within the applicable federal limits.

Ineffective System for Preventing a Collection Agency From Providing Conflicting Services on the Same Loan

Finding

The commission does not have an effective system to prevent a collection agency from contracting to collect on the same student loan for which the agency had provided supplemental preclaims assistance. Supplemental preclaims assistance consists of specified procedures, performed before the commission pays lenders for defaults on the loans, to persuade severely delinquent borrowers to repay their loans. For one of the 10 loans we reviewed, the same collection agency that provided supplemental preclaims assistance

also contracted to collect on the loan. If the same agency that performed the preclaims assistance also contracts to collect the loan, the federal government could refuse to reimburse the commission for the cost of supplemental preclaims assistance for the loan.

We reported a similar weakness in our audit for fiscal years 1988-89 and 1989-90. In its March 4, 1991, response to our management letter, the commission reported that computer edits now prevent any new cases of improperly assigned accounts. However, the erroneously assigned account we noted indicated that the commission had not fully corrected the problem.

Criteria

The Higher Education Act, Section 428(c)(6)(C) (iii), requires that in the event of default, supplemental preclaims assistance be done by an organization or entity that does not have a contract with the commission to perform collection activities for the same loans.

Recommendation

The commission should ensure that loans are not assigned for collection activities to the same collection agency that provided supplemental preclaims assistance.

Insufficient Documentation That Defaulted Loans Are Properly Reported to National Credit Bureaus and Insufficient Reporting to National Credit Bureaus

Finding

There was insufficient documentation that the commission had reported defaulted loans to all three of the national credit bureaus the commission contracts with to ensure sufficient geographical coverage. Because the commission's records indicate that information has been sent to credit bureaus but does not indicate the specific credit bureaus the commission reported to, we reviewed the credit bureaus' records also. For 3 of the 12 loans we reviewed, the commission's records indicated that it had notified the credit bureaus; however, none of the credit bureaus had any record of the defaulted loans being reported. In addition, for one of the 12 loans we reviewed, neither the credit bureaus' nor the commission's records showed any indication that the commission had notified any of the credit bureaus of the default. Further, for 4 of the 12 loans

we reviewed, either one or two of the credit bureaus did not have any record of defaulted loans being reported. Without such documentation, we cannot conclude that the commission properly reported the defaulted loans.

We also found that the commission did not report the date of loan default as required by federal regulations for any of the 12 loans we reviewed.

If defaulted loans are not properly reported or if information reported is not properly documented, a lender or other guarantee agency could use incorrect information when making or insuring loans.

We reported a similar weakness in our management letter for fiscal years 1988-89 and 1989-90. In its response of March 4, 1991, the commission stated that it consistently reports to all three national credit bureaus. The commission reported that it can find no evidence that records have not been promptly sent to the credit bureaus. The commission also stated that it had already taken corrective measures to ensure that the default date is correctly reported. The commission stated that as of February 28, 1991, all loans eligible for reporting to the credit bureaus will have the correct dates for which the loans were purchased as defaults. However, the federal regulations require that the date of default be reported to the credit bureaus not the date the loans were purchased as defaults.

Criteria

The Code of Federal Regulations, Title 34, Section 682.410(b)(3), requires the commission to report to all national credit bureaus the default date, information concerning loan collection, and the date the loan is fully repaid or discharged.

Recommendation

The commission should ensure that it has properly reported defaulted loans to all appropriate credit bureaus and should maintain records sufficient to document its reporting.

**Federal
Quarterly
Report Not
Reconciled
With
Accounting
Records**

Finding

The commission's federal quarterly report for April through June 1991 contains information that does not reconcile with the commission's accounting records. Specifically, the commission reported in the quarterly report \$507,575 more in lender claims paid and \$1,371,457 less in collections received than it recorded in its accounting records. The commission did not provide us with a reconciliation between the quarterly report and the accounting records, and we could not determine whether the quarterly report, the accounting records, or both were inaccurate.

We reported a similar weakness in our audits for each of the last five years. In its March 4, 1991, response to our management letter for fiscal year 1989-90, the commission reported that when full implementation of its Financial Aid Processing System occurred, the federal reports would reconcile with its accounting records. However, as of April 1992, the commission had not yet fully implemented its new system.

Criteria

Circular A-102, Subpart C, of the federal Office of Management and Budget, requires the State to account for grant funds in accordance with state laws and procedures. Further, the State Administrative Manual, Section 20014, requires agencies receiving federal funds to reconcile federal financial reports with the official accounting records.

Recommendation

The commission should reconcile its quarterly reports with its accounting records.

**Noncompliance
With Additional
Federal
Requirements**

Findings and Criteria

We noted the following instances when the commission did not always comply with administrative requirements of the federal government.

- The commission did not report at least \$39,717 (nearly one-tenth of one percent) of the total collections of defaulted student loans within the required 60 days. The Code of Federal Regulations, Title 34, Section 682.404(e)(4), requires the commission to submit the federal share of borrower payments within 60 days of receipt.
- The commission paid approximately \$1,800 to a lender who submitted a disability claim 32 days after the required 60-day deadline, yet the commission did not limit the interest it paid to the lender because of the late filing. The United States Department of Education, Bulletin 88-G-138, requires that if a lender files a late disability claim, the claim will be paid but the interest that accrues on the loan after the 60-day deadline is ineligible for reinsurance.
- For 4 of 40 loans we reviewed, the commission paid lenders incorrect amounts of interest on the defaulted loans it purchased from them. The errors were minor in amounts. The lenders used incorrect interest rates or an incorrect number of days in calculating the interest. Since the commission requests reimbursement from the federal government for both the amount of the defaulted loans and the related interest paid to the lender, errors in interest calculation caused the commission to request incorrect federal reimbursements.

Although individually these instances of noncompliance may appear to be insignificant, any violation of federal regulations exposes the public resources to abuse.

Recommendation

The commission should improve its compliance with federal requirements.

California Department of Education

We reviewed the financial operations and related internal controls of the California Department of Education (department) and the department's administration of the U.S. Department of Agriculture grants, Federal Catalog Numbers 10.550, 10.553, 10.555, and 10.558; the U.S. Department of Labor grant, Federal Catalog Number 17.250; the U.S. Department of Education grants, Federal Catalog Numbers 84.010, 84.011, 84.027, 84.048, 84.151, 84.173, and 84.186; and the U.S. Department of Health and Human Services grant, Federal Catalog Number 93.025.

Delay in Disbursing Federal Grant Monies

Finding

The department's cash management system does not minimize the amount of time between receiving federal funds and disbursing them to subrecipients. We tested 275 claims to determine the amount of time between receipt and disbursement. We found that for 124 claims the State held the funds between 6 and 80 days before disbursement, for an average delay of 14.5 days. Some of the delays may be attributed to the time it takes the State Controller's Office to process the disbursements. We observed similar weaknesses during our financial audit for the fiscal years 1987-88 through 1989-90.

Criteria

The Code of Federal Regulations, Title 31, Section 205.4(a), requires that the timing and amount of cash advances be as close as administratively feasible to the actual disbursement by the recipient organization. We consider a delay of no more than five days as administratively feasible.

Recommendation

The department should improve its compliance with federal requirements by minimizing the delay between the receipt of federal funds and the actual disbursement.

**Inadequate
Procedures To
Ensure That
Subrecipients
Comply With
Federal
Regulations**

Finding

The department does not sufficiently monitor the audit reports that subrecipients submit to the department. A “subrecipient” is any person, government department, local educational agency, or establishment that receives federal financial assistance through a state government to carry out a program but who is not a direct beneficiary of such a program. We selected for review 96 audit reports that subrecipients should have submitted to the department and found the following:

- The department was not able to provide us with 13 of the audit reports we selected for review. As a result, we were not able to determine whether the department ensured that these subrecipients had properly resolved any instances of noncompliance included in the reports.
- The department was not able to provide us with a list of subrecipients of the National School Lunch Program that were required to submit an audit report for the fiscal year 1989-90. Ten of the 13 audit reports that the department could not provide to us related to the National School Lunch Program. As a result, we could not conclude that the department properly monitored the receipt of the required audit reports or that it resolved instances of noncompliance included in the audit reports.
- Eighteen audit reports that we did review identified instances in which subrecipients did not comply with federal laws and regulations. For seven of these audit reports, we could not find evidence that the department ensured that the subrecipients had properly resolved these instances of noncompliance. In an eighth report, the issue was not resolved within the required six months, although the department did ensure resolution of this federal issue of noncompliance. Without proper follow-up on instances of noncompliance with federal laws and regulations, the department cannot be certain that subrecipients are complying with federal regulations. We observed a similar weakness during our financial audit for fiscal years 1987-88 through 1989-90.

In addition, the department did not obtain audit reports from 14 of the 40 private, nonprofit subrecipients participating in the State Legalization Impact Assistance Grants (SLIAG) program that were required to submit audit reports in fiscal year 1989-90. The department is responsible for ensuring that subrecipients meet the federal requirement to undergo independent audits. Unless the department obtains the audit reports, it cannot be sure that subrecipients participating in the SLIAG program complied with this requirement. Further, the department cannot determine if the subrecipients complied with the terms and conditions of the SLIAG program. We observed a similar weakness during our financial audit for fiscal year 1989-90.

Criteria

According to the federal Office of Management and Budget, Circular A-128, state or local governments that allocate \$25,000 or more of federal financial assistance to a subrecipient must determine whether subrecipients spent federal financial assistance in accordance with applicable laws and regulations. Additionally, a departmental policy memorandum to all school nutrition program sponsors requires that nonprofit subrecipients submit annual audits to the department. Also, the federal Office of Management and Budget, Circular A-110, requires private, nonprofit organizations that receive federal funds to have independent audits conducted at least biannually. For instances of noncompliance with federal laws and regulations, Circular A-128 requires that state or local governments ensure that appropriate corrective action is taken within six months of receipt of the audit reports. Finally, Circular A-128 requires the department to determine whether the private, nonprofit organizations meet the audit requirements of Circular A-110 and whether they spend federal assistance funds in accordance with applicable laws and regulations.

Recommendation

The department should ensure that it sufficiently monitors the audit reports submitted by subrecipients. Additionally, the department should ensure that subrecipients correct within six months instances of noncompliance with federal laws and regulations identified by auditors. Finally, the department should ensure that private, nonprofit organizations participating in the SLIAG program undergo independent audits at least every two years.

**Noncompliance
With Federal
Regulations
for the State
Legalization
Impact Aid
Grant**

Finding

The department did not always comply with federal requirements for the State Legalization Impact Assistance Grants program (SLIAG). We tested 32 payments to SLIAG program subrecipients, 15 of which were nongovernmental agencies, and found the following specific deficiencies:

- The department used local assistance funds when it made payments for one contract totaling approximately \$1.5 million even though the contract involved administrative services. Three of the payments we tested were related to this contract. The contract required the contractor to develop and implement a database program to allow the department to meet its reporting and accountability requirements for SLIAG and to provide teacher training teleconferences and a pre-enrollment appraisal program. Federal regulations identify these types of services as administrative, not local assistance. A department manager stated that although the budget act required that these services be provided, the department did not have administrative funds available to perform the services. Therefore, the department used local assistance funds to pay for invoices under this contract. As a result, the department had fewer local assistance funds available for educational services for disbursement to subrecipients.
- The department overpaid subrecipients on 3 of the 32 payments we tested. In two cases, the subrecipients were overpaid by \$10,371 and \$39,639, respectively, when the department failed to offset the amounts paid by the amounts the department originally advanced to these subrecipients. The overpayment of \$39,639 resulted in the department paying the subrecipient more than its original grant award. In the third case, the department paid the subrecipient \$300 more than its grant award because the department used an incorrect student count when calculating the payment. After researching these items, the department corrected the overpayments.

Criteria

The Code of Federal Regulations, Title 45, Section 402.11, states that the funds provided under the SLIAG program may be used to reimburse state and local educational agencies for expenditures for

the purpose of providing educational services to eligible legalized aliens. The Code of Federal Regulations, Title 45, Section 402.11(e)(5), states that in no event may the amount paid to the local educational agency or other provider exceed the actual cost of providing those services. In addition, the Code of Federal Regulations, Title 45, Section 402.22, allows the department, for administrative costs, 1.5 percent of the total amount the department receives for educational services. This section also states that administrative costs include planning and consultation with local officials, preparing the application, performing audits, allocating funds, tracking and recordkeeping, monitoring the use of funds, and reporting.

Recommendation

The department should recover the local assistance funds it used to pay administrative costs and should apply the funds to allowable local assistance expenditures. In addition, the department should ensure that it does not overpay subrecipients.

Possible Incorrect Interpretation of the Federal Regulations for the Drug-Free Schools and Communities Program

Finding

The department may have incorrectly interpreted federal regulations for the Drug-Free Schools and Communities program when it calculated the maximum amount it could use for program development and administrative costs for fiscal year 1990-91. Based on its interpretation of federal regulations, the department calculated the maximum amount it could use for program development and administrative costs as 10 percent of the total grant award or approximately \$3.5 million. However, in a memorandum from the United States Department of Education (USDOE), the federal government has calculated the maximum allowable program development and administrative costs as 10 percent of only a portion of the grant award called the “base allocation.” Since the base allocation was approximately \$21 million, the USDOE calculates the allowable development and administrative costs as approximately \$2.1 million. As a result, if the department has incorrectly calculated the amount it could use for program development and administrative costs, it withheld approximately \$1.4 million that it should have used for entitlements to local educational agencies.

Criteria

The United States Code, Section 3194(b), states that not more than 10 percent of the amounts available under Section 3191(b) may be used for program development and administrative costs. Section 3191(b) states that the amounts allocated to the department shall be used to carry out its responsibilities in accordance with Section 3194 and for grants to local and intermediate educational agencies. The department interprets Section 3191(b) as referring to the entire grant award, whereas the memorandum from the USDOE dated June 7, 1990, interprets this section as referring only to a portion of the grant award called the "base allocation."

Recommendation

The department should seek written clarification from the USDOE of the correct interpretation of the federal codes.

Inadequate Procedures for Monitoring Cash Advances for the Drug-Free Schools and Communities Program

Finding

The department does not have adequate procedures to ensure that cash advanced to local educational agencies (LEAs) that participate in the Drug-Free Schools and Communities program is limited to the LEAs' immediate cash requirements. Specifically, rather than making payments to the LEAs periodically as the department does for other federal programs, the department paid most LEAs the entire amount of their fiscal year 1990-91 entitlements in February 1991. This practice may allow the LEAs to accumulate federal funds beyond their immediate needs.

The department's application for fiscal year 1991-92 requires the LEAs to submit expenditure reports that would allow the department to determine whether the LEAs have accumulated excess federal cash. However, in the application for fiscal year 1990-91, the department did not require the LEAs to submit this expenditure information with the detail necessary for the department to determine their excess cash balances.

Criteria

The Code of Federal Regulations, Title 34, Section 80.20(b)(7), requires that the timing and amount of cash advances be as close as possible to the actual disbursements by the recipient organization. Further, this same section requires the department to establish procedures to ensure receipt of reports on the LEA's cash balances and cash disbursements.

Recommendation

The department should implement procedures to limit payments to the immediate needs of the LEAs. Further, the department should ensure that the LEAs provide expenditure information in the detail necessary to allow the department to determine excess cash balances.

Insufficient Monitoring of Local Educational Agencies Participating in the Drug-Free Schools and Communities Program

Finding

In August 1989, the United States Department of Education (USDOE) reported that the department did not formally monitor local educational agencies (LEAs) participating in the Drug-Free Schools and Communities program. The department responded that it plans to design a dual monitoring system that would include a district level progress reporting system and a school site visit monitoring system. As a result, the department did require the LEAs to include in their application for funding for fiscal year 1991-92 an annual progress report for fiscal year 1990-91. Thus, the department has made some progress toward developing the district level progress reporting system. Additionally, the department is requiring that the county offices of education develop a method for monitoring school districts which includes site visits at least once over a three-year period. However, the department could not provide us with documentation showing a definite plan for school site visits by department staff.

Criteria

The Code of Federal Regulations, Title 34, Section 80.40(a), requires grantees to monitor activities to ensure that the LEAs comply with applicable federal requirements and achieve performance goals.

Recommendation

The department should develop and implement on-site monitoring procedures to ensure that subrecipients are complying with federal requirements and are achieving performance goals.

Revised Indirect Cost Rates Not Submitted to the Federal Government

Finding

The department allocated indirect costs for all federal programs during fiscal year 1990-91 using rates different from those it had submitted to the federal government in its fiscal year 1990-91 provisional indirect cost rate proposal. The department revised the rates after it had submitted the proposal, but it failed to notify the federal government of these changes. If the department does not use the rates it submitted to the federal government when it charges federal programs, the department risks losing reimbursement for its indirect costs.

Criteria

Circular A-87 of the federal Office of Management and Budget requires state agencies to submit a plan for allocating indirect cost to the cognizant federal agency for approval.

Recommendation

The department should ensure that it uses the rates it submitted to the federal government in its indirect cost rate proposal when charging federal programs. When it revises the rates, the department should ensure that it informs the federal government of the changes.

Noncompliance With Other Federal Requirements

Findings and Criteria

In the following instances, the department did not always comply with administrative requirements of the federal government:

- For 4 of the 28 contractors participating in the Food Distribution program that we reviewed, the department failed to perform on-site reviews within the required five-year period.

The Food and Nutrition Service, Instruction 113-3, requires distributing agencies, as part of their ongoing management evaluation, to review on-site the civil rights compliance of each recipient agency at least once every five years.

- For 30 applications from local educational agencies for the Drug-Free Schools and Communities program that we reviewed, we found that one application was not dated, one application was not signed, one application had incomplete program resource amounts, two applications' budget summary amounts did not agree with the amount received under the grant, and two applications were late. The United States Code, Title 20, Section 3196, requires that local educational agencies submit an application and provide information and assurances as the state educational agency responsible for distributing the grant reasonably determines to be necessary.
- For 7 of 10 subrecipients participating in the Migrant Education—Basic State Formula Grant Program that we reviewed, the department distributed the second cash advance before approving either the prior year's final expenditure report or the current year's first quarter expenditure report. Additionally, the department distributed the third cash advance to four subrecipients before approving the second quarter expenditure reports. Further, for one of the 10 subrecipients, the department could not provide evidence that it had approved these reports before issuing the second and third cash advance. The federally approved state plan indicates that the State will monitor the program for fiscal compliance. The Migrant Education Office's fiscal requirements manual describes procedures for maintaining fiscal control over the migrant education program. The manual states that before releasing the second cash advance, the department must approve the first quarter expenditure report and the final expenditure report for the prior fiscal year. The manual also states that before the department releases the third cash advance, the department must approve the second quarter expenditure report.

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- The department disbursed certain apportionments for the Regional Services/Program Specialist portion of the Special Education—Preschool Grants program before receiving appropriate certifications from grant subrecipients. Specifically, for 15 of the 30 apportionments that we reviewed, the department paid more than 25 percent of the amounts apportioned before it received subrecipients' certifications that they would comply with applicable federal and state regulations. These disbursements totaled approximately \$164,000. Without the certifications, the department cannot be assured that subrecipients will comply with required regulations. The department's own policy requires the withholding of payments of more than 25 percent of amounts apportioned until it receives the certification.
 - The department did not submit the fiscal year 1988-89 final financial status report for the Vocational Education—Basic Grants to States program to the federal government until January 24, 1992, approximately 13 months after the deadline of December 31, 1990. Additionally, the department did not submit the fiscal year 1989-90 final financial status report until April 17, 1992, approximately 4 months late. The Code of Federal Regulations, Title 34, Section 74.73(d), states that when financial status reports are required on an annual basis, the reports are due 90 days after the expiration or termination of the grant.
 - The department improperly allocated administrative costs of approximately \$4,600 for July 1990 to the State's General Fund rather than to the federal Chapter 1 Programs—Local Educational Agencies. The department allocated the costs for July based on the federally approved rates for fiscal year 1987-88 rather than the approved rates for fiscal year 1990-91. The department's accounting system was revised in August 1990 to reflect the correct rates; however, the department did not adjust for the incorrect allocation of the July administrative costs. In a memorandum to the department, the United States Department of Education approved the formula for distributing costs between the General Fund and the Chapter 1 Programs for each

fiscal year from 1985-86 through 1990-91. The department should comply with the approved distribution formula. When we brought this error to its attention, the department corrected its accounting records.

Recommendation

The department should improve its compliance with each of the federal requirements.

Noncompliance With State Requirements

Finding and Criteria

In the following instances, the department did not always comply with administrative requirements of the State:

- The department did not promptly transfer to the State's General Fund reimbursements representing the federal government's share of service costs provided by central service agencies. These costs are calculated under the Statewide Cost Allocation Plan (SWCAP), which is the plan that each state agency uses to pay for its share of the State's cost for central services. The department did not transfer the SWCAP recoveries for the entire fiscal year 1990-91 until September 23, 1991. We observed a similar weakness during our financial audit for fiscal year 1989-90. The California Government Code, Section 13332.01, requires agencies to recover SWCAP costs from the federal government. Although no deadline is expressly mandated, the State Administrative Manual, Section 8755.2, implies that a transfer of SWCAP recoveries to the State's General Fund within 30 days of the end of each quarter would be appropriate.
- Starting in fiscal year 1988-89, the department began using a new funding formula to calculate the apportionment of Project Work-Ability I funds for sites established in fiscal year 1988-89 and thereafter. The new funding formula was adequately supported. However, for sites that existed prior to fiscal year 1988-89, the department continued to use its previous funding

formula for which the department did not provide adequate support. The department informed these sites that it would fund them using the new formula beginning in fiscal year 1991-92. The Education Code, Section 6471(c), requires that the superintendent develop criteria for awarding grants and funding workability projects and for evaluating the projects. The California Government Code, Section 13402 and 13403, requires agencies to ensure that a satisfactory system of internal accounting and administrative control, including a system of authorization and recordkeeping procedures, is in place to provide effective accounting control over assets, liabilities, revenues, and expenditures.

- The department did not sufficiently document the calculation of the Economic Impact Aid (EIA) entitlement. To calculate a portion of the EIA entitlement, the department uses data about those school age children living in poverty in a school district who do not receive Aid to Families With Dependent Children. This data was included in the 1980 United States Census, which reported the data by county, not by school district. Therefore, the department had to convert the data from county to school district. The department could not provide documentation to support its conversion of the 1980 census data from county to school district. We reported a similar finding in our fiscal year 1989-90 financial audit. The department stated that it intends to document the conversion of the 1990 census data for the entitlement calculations for fiscal year 1992-93. The California Government Code, Sections 13402 and 13403, requires agencies to ensure that a satisfactory system of internal accounting and administrative control, including a system of authorization and recordkeeping procedures, is in place to provide effective accounting control over assets, liabilities, revenues, and expenditures.

Recommendation

The department should improve its compliance with each of the state requirements.

General Government

Office of Criminal Justice Planning

We reviewed the Office of Criminal Justice Planning's (office) administration of the U.S. Department of Education grant, Federal Catalog Number 84.186, and the U.S. Department of Justice grant, Federal Catalog Number 16.579.

Inequitable Share of Administrative Costs May Have Been Charged to a Federal Grant

Finding

During our review of administrative costs charged to the Drug-Free Schools and Communities—State Grant (DFSC), the office did not demonstrate that it equitably charged administrative costs to the grant. The office uses the DFSC grant to administer its Suppression of Drug Abuse in Schools Program (DSP), the California Gang Violence Suppression Program, and the Comprehensive Alcohol and Drug Prevention Education Program (CADPE). We noted that, for fiscal years 1989-90 and 1990-91, the office charged the DSP and the CADPE programs 68 percent and 84 percent respectively of the direct and indirect administrative costs associated with operating these state and federally funded programs. However, the DFSC grant paid only 16 percent and 14 percent respectively of funds to subrecipients for these programs. Thus, for both fiscal years, the office charged approximately \$888,000 more direct and indirect administrative expenses to the federal grant than if the grant's share were determined by the proportionate share of the funds provided to subrecipients, which, in our opinion, is an equitable method of allocation. The office charged the grant approximately \$361,000 more for fiscal year 1989-90 and \$527,000 more for fiscal year 1990-91 than if the grant's share were determined by the proportionate share of the funds provided to subrecipients.

Criteria

The federal Office of Management and Budget, Circular A-87, limits the amount of administrative costs that may be charged to a grant to an amount that is equitable to the relative benefits received.

Recommendation

The office should ensure and demonstrate that it only charges federal grants for administrative costs that are equitable to the benefits received.

Failure To Obtain Federal Authorization To Recover All Reimbursable Administrative Costs and Use of an Incorrect Indirect Cost Rate

Finding

During our review of administrative costs for the Drug Control and System Improvement—Formula Grant (DCSI), we noted that the office made errors in calculating the rate of indirect administrative costs for fiscal years 1990-91 and 1989-90. Specifically, we noted that the office's proposed rate for indirect costs submitted to the federal government for approval included only a portion of the office's valid indirect administrative costs. The proposed rate was 7 percent. This was approved by the federal government but would have been insufficient to allow the office to recover all its reimbursable indirect costs related to the DCSI grant. However, the office actually charged costs to the DCSI grant for fiscal year 1990-91 at the rate of 34 percent of direct costs, a rate sufficient to recover all valid indirect costs, even though the federal government had approved a rate of only 7 percent of direct costs. We also reviewed costs for fiscal year 1989-90 and found that the office actually charged indirect costs to the grant at a rate of 40 percent of direct cost even though the federal government had approved a rate of only 7 percent. Thus, for both fiscal years, the office charged approximately \$435,000 more indirect costs to the federal grant than if it had used the rate approved by the federal government. The \$435,000 was approximately \$257,000 more than approved for fiscal year 1990-91 and \$178,000 more than approved for fiscal year 1989-90.

Criteria

The federal Office of Management and Budget (OMB), Circular A-87, requires that grant recipients submit rate proposals for indirect costs to the recipients' cognizant federal agency for approval. The OMB Circular A-87 also requires that recipients use rates to charge indirect costs to grants that do not exceed approved rates.

Recommendation

The office should request approval from its cognizant federal agency to retroactively revise its indirect cost rates for fiscal years 1990-91 and 1989-90.

Failure To Ensure Federal Funds Reach the Appropriate Recipients

Finding

The office did not have procedures to adequately ensure that expenditures of Drug-Free Schools and Communities—State Grant (DFSC) funds reached the appropriate recipients during fiscal year 1990-91. The office uses the DFSC funds to administer its Suppression of Drug Abuse in Schools Program, the California Gang Violence Suppression Program, and the Comprehensive Alcohol and Drug Prevention Education Program. In our review of the compliance reports submitted to the office by 20 subrecipients of DFSC grant funds for fiscal year 1990-91, we found that 4 of the subrecipients reported they did not comply with the requirement that at least 90 percent of the program participants be high-risk youths. In one of the four cases, a subrecipient reported a participation rate of only 11 percent. Two additional subrecipients either submitted an incomplete compliance report or did not submit a report. When the subrecipients report participation rates of less than 90 percent or do not submit the reports, the office cannot ensure that the federal funds are reaching the intended recipients as defined by the federal law.

We reported a similar weakness in our management letter dated March 11, 1991, related to our review for fiscal year 1989-90. In its response, dated March 11, 1991, the office stated that, as of that date, it required DFSC subrecipients to report on student populations to ensure that high-risk youth were being served.

Criteria

The interagency agreement between the office and the Department of Alcohol and Drug Programs requires the office to comply with Section 5122(b) of the DFSC Act, codified as Title 20, United States Code, Section 3192(b). Under this section, the office is required to ensure that at least 90 percent of the participants in its DFSC-funded programs are high-risk youth.

**Lack of
Sufficient
Procedures
To Ensure
Private Schools
Are Notified of
Available
Services**

Recommendation

The office should ensure that its subrecipients use DFSC grant funds for authorized activities as federal laws and regulations require.

Finding

The office does not have sufficient procedures to ensure that subrecipients of the office's Drug-Free Schools and Communities—State Grants (DFSC) include private schools in their community-based programs. As a result, the office cannot ensure that the grant funds provide for equitable participation of children and teachers from the targeted groups.

We reported a similar weakness for fiscal year 1989-90. In response to our report, the office inserted an addendum to its grant award agreements for fiscal year 1990-91 requiring the subrecipients to certify they have included in their programs the private nonprofit elementary and secondary schools in the subrecipients' districts. However, the office has no procedures to monitor whether or not the subrecipients have actually included private schools and teachers in their community-based programs. These monitoring procedures are needed to provide the office assurance that the subrecipients have initiated procedures to support the certifications made to the office.

Criteria

The interagency agreement between the office and the Department of Alcohol and Drug Programs requires the office to include participation of private schools in any school-based programs. In addition, Section 5143 of the DFSC Act, codified as Title 20, United States Code, Section 3223, requires grantees to make provisions to include services and arrangements so that there is an equitable participation of the children and teachers from the targeted groups.

Recommendation

The office should develop and implement procedures to ensure that subrecipients actually include private school children and teachers in their community-based programs.

Failure To Require Subrecipients To Provide for Review and Approval Data Related to Equal Employment Opportunity Plans

Finding

The office has not required its subrecipients under the Drug Control and System Improvement—Formula Grant to provide it, for prior federal review and approval, with data related to Equal Employment Opportunity Plans (EEOP). Specifically, the office has made awards of \$500,000 or more to 15 subrecipients without submitting required EEOP-related data from subrecipients for prior federal review and approval. The total amount of the 15 awards was \$18.6 million. Until recently, the office was unaware of the special condition requiring the office to provide subrecipients' EEOP-related data for federal review and approval before making the grant awards. However, in April 1992, the office advised us that it was implementing new requirements for fiscal year 1992-93 that will require subrecipients receiving a single grant of \$500,000 or more to submit to the office their EEOP as well as other related required information.

Criteria

Paragraph 9 of the special conditions of the Drug Control and System Improvement—Formula Grant for fiscal year 1990 requires that before the allocation of any grant funds to any subrecipient in an amount of \$500,000 or more, the office agrees to submit to the federal Bureau of Justice Assistance, for review and approval, a copy of that subrecipient's EEOP and other EEOP-related data. In addition to the subrecipients' EEOP, the office must submit information related to the number of complaints of discrimination filed against each subrecipient within the past year, the final disposition or current status of each complaint, and the nature and issues involved in each active complaint. In addition, Paragraph 9

also requires the office to include in its report whether or not the subrecipient is currently operating under an equal employment conciliation agreement and if so, a copy of that agreement, and the most recent monitoring report.

Recommendation

The office should require subrecipients applying for awards of \$500,000 or more under the Drug Control and System Improvement—Formula Grant, to provide required EEOP-related data, so the office can submit the information to the Bureau of Justice Assistance for review and approval before awarding the grants.

Department of Economic Opportunity

We reviewed the Department of Economic Opportunity's (department) administration of the U.S. Department of Health and Human Services grants, Federal Catalog Numbers 93.028 and 93.031.

Improper Cash Management

Finding

During fiscal year 1990-91, the department maintained balances of federal funds that exceeded its immediate cash needs. The department retained these excess federal funds in the state treasury from certain prior-year appropriations. Specifically, the beginning balance for these appropriations on July 1, 1990, was approximately \$6.6 million. Subsequent receipts and disbursements reduced the balance to \$.9 million on June 30, 1991. However, this amount still exceeds the department's immediate cash needs. We reported a similar weakness in our audits for fiscal years 1987-88, 1988-89, and 1989-90. Maintaining excess cash may cause the federal government to cease advancing funds.

Criteria

The Code of Federal Regulations, Title 31, Section 205.4, requires that cash advances be limited to the actual immediate cash needed for carrying out the purpose of the program. This section also stipulates that the timing and amount of cash advances be as close as administratively feasible to the actual cash disbursement by the recipient organization.

Recommendation

The department should periodically analyze its cash balances and identify any appropriations that have excess cash balances and spend those funds first before drawing down additional federal funds.

Inadequate Documentation for LIHEAP Payments

Finding

We reviewed 30 payments made directly to recipients for the Low-Income Home Energy Assistance Program (LIHEAP) and found the following:

- For one payment, the application did not contain documentation stating family size and, as a result, the department cannot document that the payment to the applicant was for the correct amount.
- For six payments, the related applications did not contain documentation for family members who may be legalized aliens and, as a result, the department cannot document that the payments to the applicants were for the correct amounts.
- In addition, we found one payment that was incorrect because the department did not adjust the payment for the number of ineligible family members.
- We also noted that 9 of the 30 checks issued for LIHEAP payments did not contain the required two endorsements for dual-party checks. When the applicant pays an energy bill directly to an energy company, the department makes payment in the form of a check payable to both the applicant and the applicant's energy company, thus, ensuring that the LIHEAP payment is for an energy bill. These 9 checks were endorsed by the applicant, but not by the applicant's energy company. Unless the endorsements are monitored, it is not certain that payments are used for program purposes.

Criteria

The department's State Plan for the Low-Income Home Energy Assistance Program (state plan) sent to the Department of Health and Human Services for fiscal year 1990-91 states that the department will make LIHEAP payments only with respect to households that meet the federal requirements. In the state plan, the department states it will achieve this by specifying and requiring verification of all eligibility criteria on the application form. Eligibility criteria required on the application includes, among other data, total monthly income and total family size.

The Immigration Reform and Control Act of 1986 (Public Law 99-603) provides that certain aliens legalized under the act are ineligible for LIHEAP benefits effective October 1, 1989.

The department's payment criteria, contained in the state plan, provides that the department will make payment in the form of a dual-party check when the applicant pays an energy bill directly to an energy company.

Recommendation

The department should improve its compliance with each of the federal requirements and with its state plan sent to the Department of Health and Human Services.

**Collection
Notices Not
Sent to Service
Providers**

Finding

The department has not assigned any staff to send out collection notices for amounts due to the department from service providers. The department has not processed collection notices for approximately four months. When the individual responsible for collection notices vacated the position, the duties were not reassigned. By not following up on outstanding receivables, the department may not collect all amounts it is owed. For example, we noted that a service provider had not made three monthly payments totaling \$6,330, and the department did not follow up on the nonpayment.

Criteria

The department's Procedure Manual, Section 2210-170, states that if a payment on an accounts receivable is not received, the department's financial services unit is required to send out up to three standard collection notices at intervals of 30 days, 60 days, and 90 days after the date of the invoice.

Recommendation

The department should assign an individual in the financial services unit to perform the duties of following up on outstanding receivables.

Department of Finance

We reviewed the Department of Finance's (department) compliance with federal and state regulations in administering the Statewide Cost Allocation Plan (SWCAP) and its compliance with state regulations in administering the Prorata Allocation Plan (Prorata).

Background The SWCAP is the plan each state agency uses to obtain federal reimbursement for the federal government's share, if any, of the State's costs for central services. The federal money is paid into the State's General Fund. The prorata is the plan that each state agency uses to obtain reimbursement from its special funds for the special funds' share, if any, of the costs for central services. The money from the special funds is also paid into the State's General Fund.

Eleven executive agencies reporting to the governor, and the Department of Justice, the Legislature, the Office of the Auditor General, the State Controller's Office, the State Library, and the State Treasurer's Office provide various central services to state agencies. These entities, called "central service agencies," provide services such as financial, personnel, and legal support. (Attachment A lists the agencies performing central services during fiscal year 1990-91 and identifies the three agencies we reviewed.)

The department allocates the costs of the SWCAP to the federal government and the costs of the prorata to the State's special funds based on costs and work load data from the central service agencies and from the governor's budget. Initially, central service costs are paid from the State's General Fund, and then, the amounts allocated to and paid by the federal government and the special funds are transferred to the State's General Fund. (Attachment B shows the estimated SWCAP and prorata expenditures and recoveries for fiscal year 1990-91.)

Work Load Data Omitted From the SWCAP and Prorata Allocations	Finding The department did not include approximately \$9.6 million in medicare costs when it calculated the SWCAP and prorata allocations for Health Benefits for Retired Annuitants for fiscal year 1990-91. This error occurred because of a miscommunication between the department and the State Controller's Office. We observed a similar weakness during our compliance audits for fiscal years 1989-90 and 1988-89. The department has corrected the error in the SWCAP plan for fiscal year 1991-92.
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As a result of the department's error, the SWCAP allocation for all agencies was understated by approximately \$161,000. Because we would need to recompute the prorata allocations for all state agencies, it was not cost-effective for us to determine the effect of the error on the prorata allocations.

Criteria

The federal Office of Management and Budget, Circular A-87, states that federal programs should bear their fair share of costs recognized under Circular A-87, except where restricted or prohibited by law. The State Administrative Manual, Sections 8753 and 8755, requires the department to use actual work load measures for each department in calculating the SWCAP and prorata allocations.

Recommendation

The department should ensure that it receives all the information necessary for calculating the SWCAP and prorata allocations.

Lack of Justification for SWCAP Budgets	Finding The department's budget analysts and the state agencies' budget analysts are responsible for calculating the SWCAP budgets. The state agencies use the SWCAP budgets to estimate the amount to be recovered and returned to the State's General Fund from their federal programs. The department's Fiscal Systems and Consulting unit provides written instructions to its own budget analysts for calculating the SWCAP budgets. However, the department's budget analysts and the state agencies' budget analysts do not always follow the department's instructions for calculating the
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SWCAP budgets or document reasons for deviating from the recommended methodology.

For fiscal year 1990-91, we recalculated the SWCAP budgets of 59 agencies following the department's recommended methodology and using the information on budgeted federal funds, state operations, and total state operations from the 1990-91 Governor's Budget. Attachment C, which lists the SWCAP budgets we reviewed during fiscal year 1990-91, shows those agencies that deviated from the department's recommended methodology and that did not provide justification for these deviations. We noted the following specific problems:

- For seven agencies, neither the department nor the state agency could provide justification for deviating from the department's recommended methodology. SWCAP recoveries estimated in the governor's budget for fiscal year 1990-91 for the seven agencies are approximately \$455,000 less than they would be if the department and the state agencies had followed the department's recommended methodology. Because neither the department nor the state agencies can provide documentation for calculation of these seven agencies' SWCAP budgets, the department cannot demonstrate that the agencies' SWCAP budgets are correct.

We reported a similar weakness in our audits for fiscal years 1986-87 through 1989-90. In December 1990, the department responded that, beginning with the SWCAP plan for fiscal year 1991-92, it had implemented new procedures that would require budget analysts to complete a form showing the calculations for the budgeted SWCAP amounts and that these forms will be retained for audit purposes.

- The department's Fiscal Systems and Consulting unit did not include one of the seven state agencies above in the SWCAP submitted to the federal government. The agency came into existence on January 1, 1991. The Fiscal Systems and Consulting unit allocated SWCAP costs to state agencies for fiscal year 1990-91 based on actual costs for fiscal year 1988-89. Because this was a new agency, there were no prior year costs on which to base the allocation and, thus, the agency was

not included in the SWCAP submitted to the federal government. Consequently, the federal government may refuse to reimburse the state for SWCAP costs that were not included in the approved plan.

Criteria

The federal Office of Management and Budget, Circular A-87, states that federal programs should bear their fair share of costs recognized under Circular A-87, except where restricted or prohibited by law. A department memorandum, dated October 18, 1989, states that the department's budget analysts are responsible for ensuring that a fair share of SWCAP costs is budgeted, recovered, and returned to the State's General Fund from federal programs.

Recommendation

The department's budget analysts should document the methodology used to calculate the SWCAP budgets of other state agencies, and the analysts should justify any deviation from the department's recommended methodology. Also, the Fiscal Systems and Consulting unit should review the information submitted by the department's budget analysts to ensure that the amount budgeted is appropriate and correctly computed.

Noncompliance With Certain Federal Requirements

Finding and Criteria

The department did not always comply with administrative requirements of the federal government. Specifically, the department made minor errors in calculating the work load data for fiscal year 1990-91 for its Budget Operation Support unit for 12 state agencies and also in calculating the department's total expenditures to include in the SWCAP. We observed similar weaknesses during our compliance audits for fiscal years 1987-88, 1988-89, and 1989-90. The federal Office of Management and Budget, Circular A-87, states that federal programs should bear their fair share of costs recognized under Circular A-87.

Recommendation

The department should improve its compliance with federal requirements.

Attachment A**Agencies Performing Central Services
Fiscal Year 1990-91**

Agency Name	Reviewed by the Office of the Auditor General
Department of Finance	X
Department of Justice	
Department of Personnel Administration	
Health Benefits for Retired Annuitants (administered by the Public Employees' Retirement System)	X
Legislature	
Office of Administrative Law	
Office of the Auditor General	
Business, Transportation and Housing Agency	
Health and Welfare Agency	
Resources Agency	
State and Consumer Services	
Youth and Adult Correctional Agency	
State Board of Control	
State Controller's Office	X
State Library	
State Personnel Board	
State Treasurer's Office	

Attachment B	Estimated SWCAP and Prorata Expenditures and Recoveries Fiscal Year 1990-91 (in millions)
Estimated SWCAP expenditures	\$346.2
Estimated SWCAP recoveries from the federal government	\$ 29.0
Percent of estimated recoveries	8.4%
Estimated prorata expenditures	\$473.4
Estimated prorata recoveries from the State's special funds	\$151.5
Percent of estimated recoveries	32.0%

Source: State of California, Department of Finance

Attachment C**SWCAP Budgets Reviewed
Fiscal Year 1990-91**

Agency Name	Lack of Justification for SWCAP Budgets
Air Resources Board	
California Arts Council	
California Coastal Commission	
California Commission on Aging	
California Community Colleges	
California Maritime Academy	
California Occupational Information Coordinating Committee	
California Postsecondary Education Commission	
California State Council on Vocational Education	
California State Department of Education	
California Student Aid Commission	
California Tahoe Conservancy	
Council for Private Postsecondary and Vocational Education	X
Department of Aging	
Department of Alcohol and Drug Programs	
Department of Boating and Waterways	
Department of the California Highway Patrol	
Department of Commerce	
Department of Conservation	
Department of Corrections	
Department of Developmental Services	X
Department of Economic Opportunity	
Department of Fair Employment and Housing	
Department of Fish and Game	
Department of Food and Agriculture	X
Department of Forestry and Fire Protection	
Department of Health Services	
Department of Housing and Community Development	X
Department of Industrial Relations	X
Department of Justice	X
Department of Mental Health	
Department of Motor Vehicles	
Department of Parks and Recreation	
Department of Rehabilitation	
Department of Social Services	
Department of Transportation	
Department of Water Resources	
Department of the Youth Authority	
Emergency Medical Services Authority	
Employment Development Department	
Energy Resources, Conservation, and Development Commission	
Hastings College of Law	
Military Department	
Office of Criminal Justice Planning	
Office of Emergency Services	X
Office of Planning and Research	
Office of the State Fire Marshal	
Office of Statewide Health Planning and Development	
Office of Traffic Safety	
Public Utilities Commission	
Seismic Safety Commission	
State Board of Control	
State Controller's Office	
State Council on Developmental Disabilities	
State Lands Commission	
State Water Resources Control Board	
The California State University	
University of California	
Veterans' Home of California	
Total	7

Department of Personnel Administration

We reviewed certain transactions within the Deferred Compensation program administered by the Department of Personnel Administration (department).

Weaknesses in Accounting for the State's Deferred Compensation Program

Finding

The department does not ensure that it properly accounts for the deferred compensation program. Specifically, as of March 1992, 21 months after it contracted with a firm to provide recordkeeping services, the department has not been able to ensure that it receives sufficient information to monitor the recordkeeping of the program. For example, the department is not able to reconcile financial information it receives, and thus, the department is not able to ensure that participants' contributions are properly accounted for. Further, because of insufficient information, it is not able to ensure that it properly withholds and reports taxes.

Effective July 1, 1990, the department entered into a five-year contract with an outside recordkeeping firm, Bankers Trust Company, (recordkeeper). The recordkeeper agreed to record transactions affecting investment plan balances and provide summary reports that would allow the department to reconcile its recorded plan balances with those reported by the investment plan trustees and by the recordkeeper in its master accounts. A master account is the total amount of the participants' contributions and earnings for each investment plan. According to the department's fiscal officer, the recordkeeper is not providing the information necessary for the department to reconcile its balances with those reported by the trustees or the recordkeeper.

For example, a plan trustee recorded a fiscal year 1990-91 beginning balance for one investment plan as approximately \$1,138,500,000. The recordkeeper reported a beginning balance for the same investment plan as approximately \$1,133,900,000,

approximately \$4,600,000 less than reported by the trustee. Although the department could materially reconcile its balance with the trustee's balance, it could not reconcile either its or the trustee's balance with the recordkeeper's balance. At the end of the fiscal year, an unreconciled difference of approximately \$6,730,000 existed between the trustee and the recordkeeper, and the department could not reconcile its balance with either the trustee's or recordkeeper's balance. If the department cannot reconcile its investment plan balances with the trustees' and recordkeeper's reported balances, the department may not be properly safeguarding plan assets.

If the department does not receive sufficient information to ensure that the recordkeeper's master account balances reconcile to the trustees' and the department's balances, then the department cannot ensure that the contributions and earnings invested by the trustees equal the total of each participant's account and that the participants' contributions have been properly invested.

An example of the department's inability to ensure that the participants' contributions were properly invested occurred in February 1991. During that month, an investment plan trustee placed approximately \$2,100,000 of participant contributions into an incorrect option within the investment plan. This money had been directed by the participants to be placed in different plan options with higher interest earnings. The department did not become aware of this error until April 1991 when the master account had already lost income of \$117,900. The three responsible parties subsequently agreed to reimburse the master account for this loss. The investment trustee and the recordkeeper agreed to pay \$50,000 each, and the department agreed to pay the remaining \$17,900. The computed loss ultimately increased to approximately \$132,800. Department records indicate that the trustee and recordkeeper paid approximately \$56,300 each and the department paid approximately \$20,200 out of the program earnings.

Finally, the recordkeeper agreed to calculate and promptly deposit federal and state tax withholdings for the department and to provide the department with monthly detailed payment reports, copies of federal tax deposit coupons, and federal and state quarterly tax returns. According to the department's plan administrator, the recordkeeper has not provided complete and accurate monthly detailed payment reports or copies of tax deposit coupons and quarterly tax returns, and therefore, the department cannot verify that deposits were made or that tax returns were filed promptly. If the department cannot properly monitor its tax withholding and reporting, tax withholdings may not be correct or promptly deposited, and federal and state tax returns may be incorrect or filed late.

For example, the department's inability to properly monitor tax reporting has allowed the recordkeeper, on behalf of the department, to file at least one quarterly federal tax return late. Although the department may recover certain costs from the recordkeeper, the department is ultimately responsible for penalties and other adverse effects that could result from inaccurate or late tax withholding or reporting.

According to the department's fiscal officer, the department's inability to reconcile investment plan balances with the trustees' and the recordkeeper's reported balances, as well as its inability to monitor tax withholding and reporting is due to the lack of prompt, complete, and accurate transaction reports, which should be provided by the recordkeeper. In July 1990, the recordkeeper agreed by contract to provide the department with specified transaction reports. According to the department's fiscal officer, the department met with the recordkeeper several times to discuss the department's concern. However, the department's fiscal officer stated that, although the recordkeeper has devoted more resources in this area, as of March 1992, the department was still not receiving complete and accurate information. Additionally, the department's plan administrator states that, although the recordkeeper has shown progress, the department is still not receiving all requested information. The department has asked the State Controller's Office to review the recordkeeper's performance on its contract.

Criteria

The California Government Code, Sections 13402 and 13403, requires departments to ensure that a satisfactory system of internal accounting and administrative control is in place to provide effective accounting control over assets, liabilities, revenues, and expenditures.

Recommendation

The department should ensure that it has sufficient information to properly account for the State's deferred compensation program by ensuring that the recordkeeper adheres to the contract provisions.

Health and Welfare

Department of Alcohol and Drug Programs

We reviewed the Department of Alcohol and Drug Programs' (department) administration of the U.S. Department of Education grant, Federal Catalog Number 84.186, and the U.S. Department of Health and Human Services grant, Federal Catalog Number 93.992.

Lack of Independent Peer Reviews of Providers

Finding

The department does not provide independent peer reviews of many providers of alcohol and drug treatment services receiving federal funds from the Alcohol and Drug Abuse and Mental Health Services (ADAMHS) block grant. The purpose of an independent peer review is to assess the quality and appropriateness of treatment services provided by entities receiving these funds. During our review of 63 providers of alcohol and drug treatment services, we found the department had not performed independent peer reviews for 49 (78 percent) of the providers.

We reported a similar finding in our audit for fiscal year 1989-90. In its response to the previous year's report, the department agreed it was only partially complying with the requirement for independent peer reviews; however, it also stated that the federal Office of Treatment Improvements (OTI) has not developed or implemented regulations or guidelines for states to follow. In addition, the department stated that the peer review process requires greater clarity and definition from the federal government although such direction appears to be forthcoming. Specifically, the OTI is creating a National Consensus panel to develop clear definitions and guidelines for quality improvement. Finally, the department stated that, since it believes there is no immediate threat to funding if it delays action on this issue, it plans to build upon existing components currently in place at the state, county, and provider levels.

Criteria

The United States Code, Title 42, Section 300x-4 (c)(5), requires the department to provide periodic independent peer reviews to assess the quality and appropriateness of treatment services provided by entities receiving funds from the Alcohol and Drug Abuse and Mental Health Services block grant.

Recommendation

The department should develop and implement procedures necessary to provide periodic independent peer reviews of all providers of alcohol and drug treatment services.

Lack of Procedures To Monitor the Drug-Free Schools and Communities— State Grants

Finding

The department does not have procedures to properly monitor the subrecipients of the Drug-Free Schools and Communities—State Grants (DFSC). The department's subrecipients include counties, nonprofit organizations, and state agencies. During our review of one of the state agency subrecipients, the Office of Criminal Justice Planning (OCJP), we noted that, although the OCJP submitted quarterly reports to the department, the reports did not provide sufficient information to identify the number of high-risk youths participating in the program. Consequently, the department did not have enough information to determine whether at least 90 percent of the participants are high-risk youths.

We reported a similar weakness in our audit for fiscal year 1989-90. In its audit response dated March 19, 1991, the department stated it would monitor its contract with OCJP to ensure that 90 percent of the youths participating in the program are high-risk youths. However, during our review of the quarterly reports the OCJP submitted to the department, we noted that the statistics were either incomplete or did not reflect the correct reporting period. Because the department lacks procedures to properly monitor the DFSC grants, the State may not be able to assess the progress of the program, verify the achievement of objectives, or ensure proper use of the funds.

Criteria

The Code of Federal Regulations, Title 34, Subtitle A, Section 80.40, requires recipients of federal grants to monitor grant-supported activities to ensure compliance with applicable federal requirements. The United States Code, Title 20, Section 3192 (b)(1), requires the State to spend at least 50 percent of the DFSC grants on community-based programs designed for high-risk youths. Finally, the United States Code, Title 20, Section 3192 (b)(3), requires the State to ensure that at least 90 percent of the participants in the program be high-risk youths.

Recommendation

The department should monitor its subrecipients' grant activities to ensure they comply with all applicable federal requirements.

Lack of Procedures To Monitor Cash Balances

Finding

The department lacks adequate procedures to monitor the cash balances of subrecipients for the Alcohol and Drug Abuse and Mental Health Services (ADAMHS) and the Drug-Free Schools and Communities—State Grants (DFSC). We reported a similar weakness in our report for fiscal year 1989-90. In its response on March 19, 1991, the department stated it had implemented procedures to monitor the cash balances of subrecipients. Specifically, the department initiated a procedure requiring subrecipients to submit quarterly cash reports to the department. However, the department lacks procedures to review and evaluate these reports. Furthermore, the department has not established procedures to adjust subsequent monthly advances based upon the cash balances reported by the subrecipients.

During our review of the quarterly reports counties submitted for the ADAMHS and the DFSC grants, we noted that 10 counties reported cash balances for the ADAMHS block grant that the counties estimated would last at least 30 days, and 11 counties reported similar cash balances for the DFSC grant. Although these counties reported cash balances, we noted only one case for which the department withheld or adjusted subsequent monthly advances.

In this case, the department did not withhold subsequent advances until the county, which reported a cash balance of more than \$800,000, submitted a letter to the department asking it to withhold advances for two months because the county's spending rate was much slower than planned. Finally, of the 34 counties that reported cash balances, 21 submitted either incomplete or inaccurate quarterly reports.

Because the department lacks procedures to evaluate the quarterly reports, it cannot be sure that monthly cash advances are limited to the minimum and immediate cash needs of the subrecipients. Consequently, the State may be advancing federal funds to subrecipients before they need the money. The department's failure to limit cash advances to minimum and immediate needs could jeopardize future advances of federal ADAMHS and DFSC grant funds.

Criteria

The Code of Federal Regulations, Title 31, Section 205.4(a), requires that cash advances to a primary recipient organization be limited to the minimum amounts needed and be timed to be in accord with only the actual, immediate cash requirements of the recipient organization. The timing and amount of cash advances must be as close as is administratively feasible to the actual disbursements by the recipient organization for direct program costs and the proportionate share of any allowable indirect costs. The Code of Federal Regulations, Title 31, Section 205.4(e), requires that advances by primary recipients to subrecipients conform substantially to these same standards of timing and amount.

Recommendation

The department should develop and implement procedures to evaluate the accuracy and completeness of the quarterly cash reports submitted by subrecipients. In addition, the department should develop guidelines to determine when to adjust a subrecipient's monthly cash advance or to require the subrecipient to refund excess cash. These procedures and guidelines should ensure that the department's cash advances are as close as is administratively feasible to the subrecipients' actual disbursements.

**Errors in
Allocating
Administrative
Costs**

Finding

The department did not properly allocate administrative costs to all programs and activities benefiting from department administrative support. Specifically, the department did not allocate indirect administrative costs to the Data Management Section, the Audits Services Branch, the Data Collection grant and the Drug-Free Schools and Communities—State Grants. Instead, other federal grants and state programs were charged for the indirect costs attributable to these programs and activities.

The department's internal auditor first reported this condition in the department's Report on Internal Controls issued in November 1991. In its response to the internal audit report, the department stated it would use a step in the CALSTARS cost allocation system for fiscal year 1992-93 to properly allocate indirect costs attributable to the Data Management Section and the Audit Services Branch.

Federal guidelines for the Data Collections grant and the DFSC grants establish limits for the amount of grant funds that may be used in support of administrative costs. To ensure that the department complies with federal cost principles without exceeding these limits, the department stated that it would capture the administrative costs for these grants and then reallocate to its general fund those costs that exceed the limits.

Criteria

The Code of Federal Regulations, Title 45, Subtitle A, Part 92, Section 92.22 and Title 34, Subtitle A, Part 80, Section 80.22, requires that allowable costs be determined by using the cost principles contained in the Office of Management and Budget, Circular A-87. Circular A-87 states that costs should be allocated to grant programs in accordance with the benefits received. In addition, the circular states that any costs allocable to a particular grant may not be shifted to other federal grant programs.

Recommendation

The department should ensure that administrative costs are allocated in accordance with federal cost principles as outlined in the Office of Management and Budget, Circular A-87.

Lack of Documentation To Support the Basis for Fixed-Rate Allocations

Finding

The department lacks sufficient documentation to support the fixed-rates used to allocate costs to certain programs. During our review of the cost allocation plan and the cost allocation table, we noted that, in cases where a fixed percentage was used to allocate costs, the department could not provide statistical data or other documentation to justify the basis for the fixed percentage used to allocate costs to certain programs. As a result, the department cannot demonstrate that the costs allocated are equitable relative to the benefits received by the program.

Criteria

The Code of Federal Regulations, Title 45, Subtitle A, Part 92, Section 92.22 and Title 34, Subtitle A, Part 80, Section 80.22, requires that allowable costs be determined by using the cost principles contained in the Office of Management and Budget, Circular A-87. Circular A-87 states that costs should be allocated to grant programs in accordance with the benefits received.

Recommendation

The department should clearly document and regularly update the basis it uses to determine fixed-rate allocations to ensure that costs are allocated to programs based upon the benefits received by the program.

State Accounting Procedures Not Followed in Charging Expenditures to Federal Block Grants

Finding

The department charged some costs directly to the Alcohol and Drug Abuse and Mental Health Services (ADAMHS) block grant rather than allocating them to those objectives that benefitted from the support costs. For example, the department purchased a copy machine for its Business Services Unit and charged the expenditure directly to the ADAMHS block grant. According to state procedures, the cost for this purchase should have been charged to administration and then allocated to all the objectives that received benefits from the purchase.

The department's internal auditor first identified this error in the department's Report on Internal Controls issued in

November 1991. In its response to the internal audit report, the department stated that it will use state accounting procedures in allocating indirect costs to federal block grant funds.

Criteria

The Code of Federal Regulations, Title 45, Subtitle A, Part 96, Section 96.30, requires states to obligate and spend federal block grant funds in accordance with state laws and procedures. Section 8752.1 of the State Administrative Manual defines departmental indirect costs as support costs that usually benefit more than one cost objective or organizational unit. Included in these costs are personal services costs of support units, department administrative costs, and operating expenses and equipment costs not included as part of the department's direct costs. Finally, this section states that these costs are to be accumulated and assigned to the cost objectives that benefit from the support activity.

Recommendation

The department should comply with state laws and state accounting procedures for charging direct and indirect costs to federal block grant funds.

Noncompliance With Certain Federal Requirements

Finding and Criteria

The department did not always comply with administrative requirements of the federal government. We noted that the department does not have an on-going procedure to inform its employees about the requirements of the federal Drug-Free Workplace Act (act) of 1988. The act requires all recipients of federal grants to have an on-going drug-free workplace program.

Although this instance of noncompliance may not appear to be significant, it is a deviation from a federal requirement designed to ensure that the public's resources are not vulnerable to abuse.

Recommendation

The department should ensure that it complies with the Federal Drug-Free Workplace Act of 1988 by maintaining an on-going procedure to inform its employees about the requirements of the act.

Employment Development Department

We reviewed the financial operations and related internal controls of the Employment Development Department (department) and the department's administration of the U.S. Department of Labor grants, Federal Catalog Numbers 17.207, 17.225, 17.246, and 17.250, and the U.S. Emergency Management Agency grant, Federal Catalog Number 83.516.

Incorrect Assessment of Penalty and Interest on Late Tax Remittances

Finding

The department did not correctly assess penalties and interest on 8 of the 44 late employer tax remittances we tested. Specifically, the department underassessed penalties and interest on 5 late tax remittances and underassessed interest on 3 late tax remittances. Although the dollar amounts of the errors in the sample were not significant, the frequency of error indicates weak internal controls. All of the errors occurred because the cashiering group incorrectly entered the postmark date of the remittances on the employers' tax forms. We reported a similar weakness during our financial audit of fiscal year 1989-90.

Criteria

The California Unemployment Insurance Code (CUIC), Section 1112, requires the department to assess a 10 percent penalty on late employer tax remittances. In addition, the CUIC, Section 1113, states that employers are liable for interest on late tax remittances from the date of delinquency until the date paid.

Recommendation

The department should continue to remind the cashiering group staff that it is important to enter the postmark date on the tax forms correctly.

Overstated Liabilities and Expenditures**Finding**

The department's Employment Training Panel did not adequately analyze its employment training contracts outstanding on June 30, 1991. Twenty-four of the 63 contracts we reviewed ended prior to June 30, 1991, but had outstanding balances. The Employment Training Panel later determined that 22 of these contracts should have been closed by the end of the fiscal year or that no additional payments would be made on these contracts. As a result, the department overstated the liabilities and expenditures in its Employment Training Fund as of June 30, 1991, by at least \$13 million.

Criteria

When state agencies prepare their year-end liability accruals, the State Administrative Manual, Section 10544, requires them to analyze their contracts and adjust the amounts of their liabilities to approximate the actual expenditures they will incur.

Recommendation

The department's Employment Training Panel should analyze its employment training contract balances early enough to ensure that the June 30 liability accrual approximates the actual expenditures it will incur.

Duplicate Payments Made for the Federal Disaster Unemployment Assistance Program**Finding**

The department needs to strengthen its controls to prevent duplicate payments for the federal Disaster Unemployment Assistance program. In the 31 claimant files we reviewed, we found two instances in which the department made duplicate payments for disaster unemployment assistance. Each duplicate payment represented one week of benefits at approximately \$100. These duplicate payments occurred because the department's staff did not post the initial payments to the claimants' payment logs. When the department received duplicate invoices, there was no record on the claimants' payment logs to indicate that payment for the specific period had already been authorized.

Criteria

The Code of Federal Regulations, Title 29, Section 97.20, requires state agencies to expend and account for federal grant funds in accordance with state laws and procedures for expending and accounting for their own funds. The State Administrative Manual, Section 8422.1, requires state agencies to determine, when submitting invoices for payment, that they have not previously paid the invoiced amount.

Recommendation

The department should ensure that it has sufficient controls over its administration of the federal Disaster Unemployment Assistance program to prevent duplicate payments.

Late Resolution of Audit Reports

Finding

In fiscal year 1990-91, the department did not resolve questioned costs in 16 of 65 audit reports for subgrantees of the Job Training Partnership Act program within the required six months of the subgrantees' receipt of the final audit report. Failure to resolve questioned costs can result in additional questioned costs if the subgrantees do not correct deficiencies in their internal controls within a reasonable time.

We reported a similar weakness during our financial audits for the six previous fiscal years. Last year we indicated that the number of audit reports that were resolved late had decreased since the establishment of a special audit resolution unit in the Job Training Partnership Division. However, the number of audit reports that were resolved late almost doubled in fiscal year 1990-91. According to the supervisor of the audit resolution unit, his staff has had to allocate time intended only for the resolution of audit reports to other activities and responsibilities.

Criteria

The Office of Management and Budget, Circular A-128, requires the department to ensure that subgrantees take appropriate corrective action within six months after the subgrantees receive their audit reports.

Recommendation

The department should increase its efforts to reduce delays in the resolution of audits so it can resolve questioned costs in all subgrantees' audit reports within six months after the subgrantees receive the reports.

Late Federal Financial Reports	Finding
	<p>The department did not submit its monthly Unemployment Insurance Financial Transaction Summary reports to the federal government within ten business days after the end of the month, as required, for any of the months of fiscal year 1990-91. The department submitted the reports as late as 35 business days after the deadlines. In addition, the department did not submit its quarterly reports showing the expenditures and financial condition of federal funds for unemployment compensation for federal employees and ex-servicemembers within 25 days, as required, for any of the quarters during fiscal year 1990-91. The department submitted the reports as late as 80 days after the deadline. The department stated that it cannot promptly submit the reports because it cannot summarize the information within the required time. Failure to promptly submit these reports may place the department in jeopardy of fiscal sanctions imposed by the federal government.</p>

We reported a similar weakness during our financial audits for the seven previous fiscal years. The department reports that, once it has fully implemented its single client data base, it will be able to submit the reports within the required time. The department anticipates that by January 1993, it will be able to submit the reports within the required time.

Criteria

The Employment Security Manual, Part V, Section 9320, requires the department to submit the Unemployment Insurance Financial Transaction Summary report within ten business days after the end of each month. In addition, the Employment Security Manual, Part V, Section 9336, requires the department to submit the report showing the expenditures and financial condition of federal funds

for unemployment compensation for federal employees and ex-servicemembers by the 25th day after the end of each quarter.

Recommendation

The department should continue to automate its accounting systems so it can submit reports within the required time.

Incorrect Charges to the Employment Service Program

Finding

The department did not always correctly charge the costs associated with employee training to the federal Employment Service program. We tested 20 operating expenses of the Employment Service program. Six of the operating expenses tested were costs associated with employee training, such as class registration fees, speaker fees, and travel expenses. We found that two of the six items were incorrectly charged to the Employment Service program. Specifically, the department incorrectly charged the travel costs associated with in-service training for one employee to the Employment Service program. This employee did not work on the Employment Service program, but on a separately funded program. The department's administrative manual states that the Employment Service program should not be charged for the cost of activities performed for a separately funded program.

For the other item, the department incorrectly charged the entire cost for a conference speaker to the Employment Service program. The cost was initially coded to be split between the Employment Service program and the Unemployment Insurance program; however, the split was not made because of an input error.

In addition, we found that the department may have incorrectly charged two additional items to the Employment Service program. Specifically, the department did not have sufficient evidence to indicate that the outside training registration fees for two employees should have been fully charged to the Employment Service program rather than proportionately to the programs on which the employees worked. These two employees worked on both the Employment Service and the Unemployment Insurance programs during the months in which the training occurred.

Criteria

The Office of Management and Budget, Circular A-87, states that, for costs to be allowable under a grant program, costs must be consistent with the department's policies and procedures that apply uniformly to both federal and state programs. Further, these costs must not be allocable to any other federally funded programs. Although the department was not able to provide us with a written policy, a department official stated that training costs that cannot be directly charged to a specific program are generally allocated among programs based on reasonable and equitable methods. The official further stated that these methods may include allocating the costs proportionately between the programs the employee charges time to during the period of training.

Recommendation

The department should strengthen its controls to ensure that it properly charges the costs associated with employee training to the correct program. As a first step in this process, the department should fully document its policy and distribute the policy to its employees.

Noncompliance With Other Federal Requirements

Findings and Criteria

In the following instances, the department did not always comply with administrative requirements of the federal government:

- The department did not have documentation to show that it properly monitored the cash balances of a secondary recipient of the Job Training Partnership Act program. The department requires its subrecipients to submit monthly cash status reports. We found that the cash status reports from August 1990 through June 1991 for one subrecipient indicated that the subrecipient may have had excess cash during these months. The department did not have any documentation that it performed procedures to determine whether the subrecipient actually maintained excess cash during these months. The Code of Federal Regulations, Title 31, Section 205.4(a), requires that cash advances to primary recipients be limited to the

minimum amounts needed and be timed to accord with the actual, immediate cash requirements of the recipient in carrying out the purpose of the approved program or project. The Code of Federal Regulations, Title 31, Section 205.4(e), requires that advances made to secondary recipients are to conform substantially to the same standards of timing and amount as apply to federal advances to primary recipients. In our opinion, proper compliance with federal regulations requires that primary recipients regularly monitor the cash balances of secondary recipients.

- The department made a clerical error when it prepared one of its quarterly federal cash transaction reports that included data for the Unemployment Insurance and the Employment Service programs. As a result of the error, the department overstated the federal share of expenditures on the report by approximately \$11,000. After we notified the department of the error, it subsequently corrected this error in its report due to the federal government in April 1992. The Code of Federal Regulations, Title 29, Section 97.20, requires that the department's financial management system provide accurate, current, and complete disclosures of the financial results of each grant program.

Although individually these instances of noncompliance may appear to be insignificant, any violation of federal regulations exposes the public's resources to abuse.

Recommendation

The department should improve its compliance with each of these federal requirements.

Health and Welfare Agency Data Center

We reviewed the financial operations and related internal controls of the Health and Welfare Agency Data Center (data center).

Possible Liability to the Federal Government	Finding
	<p>The data center provides data processing services, procures electronic data processing equipment, and provides related training services to state agencies. During fiscal years 1984-85 through 1990-91, the data center charged state agencies for more than the costs it incurred. State agencies, in turn, allocated a share of the data center's billing to federal programs. Thus, the federal programs absorbed a portion of the excess charges. Charging the federal programs more than their share of costs is a violation of federal regulations. Consequently, the data center may have a liability to the federal government of approximately \$8.8 million for profits it accumulated in its revolving fund from July 1, 1984, through June 30, 1991. The amount represents approximately 38 percent of the data center's profits accumulated over these seven years. If proposed changes in federal regulations are adopted retroactively, the possible liability would be substantially reduced. We reported a similar finding during our financial audits for fiscal years 1988-89 and 1989-90.</p>

Officials of the data center estimated the federal share of accumulated profits. We did not verify the accuracy of the estimate. In a previous settlement between the State and the federal government on the same issue for the years from 1969 to 1984, the federal share of accumulated profits was 58 percent rather than the 38 percent estimated this year. The officials of the data center contend that its newer customers have a lower federal funding ratio, and therefore, the relative share of the data center's services for federal programs has decreased since 1984.

The data center is able to overbill state agencies because, in part, the Department of Finance (DOF) has not developed accounting procedures that ensure that the data center does not charge federal programs, through the state agencies, more than its costs. When the director of the DOF responded to our management letter for fiscal year 1989-90, he stated that the State is working with the federal government to minimize differences between state and federal laws and regulations in this area. He stated that once the differences are resolved, the DOF will develop guidelines for the State.

Criteria

The California Government Code, Section 13070, provides the DOF with general powers of supervision over all matters concerning the financial and business policies of the State. The California Government Code, Section 11755, allows the data center to accumulate profits in its revolving fund up to certain limits. However, the federal Office of Management and Budget, Circular A-87, "Cost Principles for State and Local Governments," prohibits the State from charging federal programs for amounts that exceed costs. Proposed amendments to Circular A-87 would allow the State to retain a reasonable working capital reserve of up to 60 days' cash expenditures, excluding the costs for capital items.

Recommendation

The data center and the DOF should develop accounting procedures to ensure that the State complies with federal regulations. Procedures could consist of developing billing rates that reflect only costs or developing two billing rates, one that can be charged to state programs and another that can be charged to federal programs. In addition, the data center and the DOF should monitor the approval of the proposed amendments to Circular A-87 and should determine the effect the revisions may have on the State's charges to federal programs.

Department of Health Services

We reviewed the financial operations and related internal controls of the Department of Health Services (department) and the department's administration of the U.S. Department of Agriculture grant, Federal Catalog Number 10.557, and the U.S. Department of Health and Human Services grants, Federal Catalog Numbers 93.025, 93.026, 93.778, and 93.994.

Delays in Requesting Reimbursement From the Federal Government

Finding

The department did not promptly request reimbursement from the federal government for costs incurred for the Maternal and Child Health Services Block Grant (MCH). Specifically, for July 1990 to March 1991, the department used approximately \$11 million in general fund monies to pay subrecipients of the MCH program. However, the department did not request federal funds to reimburse the general fund for these expenditures until May 23, 1991, between 52 to 295 days after the state paid the expenditures. We also reviewed a sample of 15 payments to MCH subrecipients, totaling approximately \$2.1 million, for April through June 1991. The department made these payments an average of 25 days before it received the federal funds. Based on our analysis of the disbursements and reimbursements for the year, we estimate that the State lost interest earnings of approximately \$429,000 because of its delays in requesting federal reimbursement for costs incurred for the MCH Block Grant.

We reported a similar weakness in fiscal year 1989-90. In its response to our management letter, dated March 12, 1991, the department stated that it would make requests for federal reimbursement on an estimated basis each month. However, the department used this procedure only for its administrative costs incurred related to the MCH program, and not to obtain prompt federal reimbursement for its payments to subrecipients. Payments to subrecipients comprise approximately 82 percent of the total MCH costs of the department.

Criteria

The State Administrative Manual, Section 0911.4, requires state agencies to secure prompt reimbursement from federal grant funds for goods and services provided.

Recommendation

The department should promptly request reimbursement from the federal government for costs incurred for federal programs.

Incorrect Payments to SLIAG Service Providers	Finding
	<p>The department's Primary Health Services Development Program (program) does not always ensure that payments to State Legalization Impact Assistance Grant (SLIAG) service providers are in accordance with approved contract rates or that invoices are correct before payments are made. We tested 44 invoices, totaling approximately \$1.3 million, that the program processed. To some extent, we focused our testing on areas where we found the program was not following its own procedures related to the review of provider invoices. From this review, we found the following conditions, which resulted in overpayments of approximately \$38,500:</p> <ul style="list-style-type: none">• The program paid five invoices using rates in excess of contract rates approved by the department. Specifically, for services provided in March, April, and May 1991, the program paid three invoices submitted by a provider who used a rate that exceeded the rate allowed according to the approved contract. As a result, the program overpaid the provider approximately \$21,000.• The program paid eight invoices that contained incorrect information related to the number of eligible legalized aliens (ELA) who received service from the providers. The program also paid six invoices that included charges for ELA's whose Temporary Resident Cards had expired before the services were provided. As a result, the program overpaid providers approximately \$17,500.

Criteria

The State Administrative Manual, Section 8422.1, requires the department to ensure that invoices comply with provisions of applicable contracts before submitting claim schedules to the State Controller's Office for payment. The Code of Federal Regulations, Title 45, Section 402.21(c), states that for public health programs, only the cost of services to eligible legalized aliens is allowable.

Recommendation

The department's Primary Health Services Development Program should ensure that its staff follow current procedures for reviewing invoices for accuracy. The program should also consider reassessing the accuracy of invoices that may not have been adequately reviewed to determine the extent of any additional overpayments. Finally, the program should attempt to recover the overpayments made to providers.

Food Vouchers Not Reconciled Promptly

Finding

For each month of fiscal year 1990-91, the department was late in reconciling at least 27 percent of the food vouchers it issued with the food vouchers redeemed by participants in the federal Special Supplemental Food Program for Women, Infants, and Children (WIC). For the year, approximately 76 percent of the food vouchers redeemed were reconciled late. The department did not complete the reconciliations within 150 days of the first day of authorized use. We estimate that the food vouchers redeemed in fiscal year 1990-91 were reconciled an average of 187 days after the first day of authorized use. Failure to promptly reconcile the vouchers may delay detection of irregularities such as the redemption of fraudulent food vouchers.

We reported a similar weakness during our audits for fiscal years 1987-88, 1988-89, and 1989-90. In its response to our fiscal year 1989-90 management letter, dated March 12, 1991, the department stated that it was in compliance with the 150-day requirement for the month of August 1990 and it should be in ongoing compliance within a few months. However, based on our review, the department had not complied with the 150-day requirement for any of the months for the year ended June 30, 1991.

Criteria

The Code of Federal Regulations, Title 7, Section 246.12(n)(1), requires the department to reconcile the food vouchers it issued with the food vouchers redeemed by participants within 150 days of the first date of authorized use.

Recommendation

The department should ensure that it reconciles food vouchers redeemed within 150 days of the vouchers' issue date.

Suspension of Procedures for Detecting and Resolving Dual Enrollment

Finding

In July 1987, the department suspended its procedures for detecting dual enrollment in WIC because the procedures did not operate as intended and produced inaccurate reports. These reports were intended to detect WIC participants who may have enrolled at more than one location. The department's failure to produce accurate reports reduced its ability to detect and resolve participant abuses.

We reported a similar weakness in our audits for fiscal years 1987-88, 1988-89, and 1989-90. In its response to our fiscal year 1989-90 management letter, dated March 12, 1991, the department stated that revised reports have been prepared as of December 1990. The department further stated that the accuracy of these reports was being tested at various local agencies and that the process should be completed by April 1991. As a result, all local agencies should receive the reports necessary to investigate and resolve potential dual enrollment by May 1991. However, the department has not completed the process of distributing the reports to all local agencies as of April 1992.

Criteria

The Code of Federal Regulations, Title 7, Section 246.7(k), requires the department to detect instances of dual participation.

Recommendation

The department should increase its efforts to establish reliable procedures to detect instances of dual participation.

**Lack of
Procedures To
Ensure Audits
of Nonprofit
Subrecipients
Comply With
Federal
Requirements**

Finding

The department did not ensure that audits of nonprofit subrecipients of the Maternal and Child Health Services Block Grant funds complied with the Office of Management and Budget Circular A-133. Additionally, the department was able to provide us with audit reports for only 13 of the 48 nonprofit subrecipients that we selected for review. Without these audits, the department lacks assurance that nonprofit subrecipients are complying with federal laws and regulations.

We reported similar weaknesses during our audit for fiscal year 1989-90. In its response to our fiscal year 1989-90 management letter, dated March 12, 1991, the department stated that, beginning in fiscal year 1990-91, nonprofit agencies that contract with the department are required to have an annual audit and that copies of the audit must be submitted to the department.

Criteria

The Federal Office of Management and Budget (OMB) Circular A-133, which describes audit requirements for nonprofit agencies, requires the State to ensure that its nonprofit subrecipients receive these audits at least every two years. It further states that audits under this circular should be an organization-wide audit.

Recommendation

The department should ensure that nonprofit subrecipients are audited at least every two years.

**Delays in
Disbursing
Federal Funds
for the SLIAG
Program**

Finding

During fiscal year 1990-91, the department maintained balances of federal funds that exceeded its immediate cash needs. For 17 of the 22 transactions we tested related to the SLIAG program, the department requested and received approximately \$1.8 million in federal funds. However, the department did not spend the funds until 7 to 150 days after it had received them. The average number of days between receipt and disbursement was approximately 33 days.

Criteria

The Code of Federal Regulations, Title 31, Section 205.4(a), requires that cash advances be limited to the actual immediate cash needs for carrying out the purpose of the program. This section also stipulates that the timing and amount of cash advances be as close as administratively feasible to the actual disbursement by the recipient organization.

Recommendation

The department should properly control its system for managing its federal funds to ensure that its requests for federal funds are limited to its immediate cash needs.

Federal Reimbursements Not Identified and Requested

Finding

The department did not identify and request reimbursement from the federal government for certain federally reimbursable costs incurred under the Child Health and Disability Prevention (CHDP) Branch. Counties under contract with the department provide CHDP services and bill the department for repayment. The federal government will reimburse the department for certain costs that county CHDP staff incur in serving children eligible for Medi-Cal. However, because the counties participating in the CHDP program during fiscal year 1990-91 did not identify federally reimbursable costs, and the department did not have an alternative system in place to identify these costs, the department did not request the reimbursements. Similarly, we were not able to determine the amount of costs eligible for federal reimbursement. However, in fiscal year 1988-89, the last year the department claimed federal reimbursement for CHDP costs, the total eligible costs amounted to approximately \$39,000.

We reported a similar weakness during our audit for fiscal year 1989-90 when we determined that the department had claimed reimbursement for fiscal year 1988-89, but not for fiscal years 1987-88 and 1989-90. In its response to our fiscal year 1989-90 management letter, dated March 12, 1991, the department stated that it was obtaining the information needed to obtain federal

reimbursement for eligible CHDP costs incurred in fiscal year 1989-90. The department also stated that a procedure had been established that would identify the specific functions allowable for federal reimbursement. However, as of March 1992, the department had not identified the eligible costs for federal reimbursement for either fiscal year 1989-90 or 1990-91.

Criteria

The State Administrative Manual, Section 0911.4, requires state agencies to secure prompt reimbursement from federal grant funds for goods and services provided.

Recommendation

The department should continue its efforts to establish a system to identify federally reimbursable costs that the counties incur and should promptly request federal reimbursements.

Erroneous Report of Uncleared Collections in the Other Health Coverage Unit

Finding

The department's other health coverage unit in the Recovery Branch did not maintain a reliable quarterly Report of Uncleared Collections, which the department uses to match and clear accounts receivable with amounts collected. For example, most of the entries in the quarterly report for June 30, 1991, represented errors, duplications, and items that the department had already cleared. As a result, the department wasted staff time by correcting errors and duplicating its prior efforts.

We reported a similar weakness during our audit for fiscal year 1989-90. In its response to our fiscal year 1989-90 management letter, dated March 12, 1991, the department said the Recovery Branch was in the process of implementing a system that should eliminate the major reasons for the large uncleared balances. The department further stated that the new system should be operational in April 1991. However, although the new system was implemented in April 1991, as of April 1992, the department was unsure of the reliability of the reports because of an error in the system.

Criteria

The California Government Code, Section 13402, requires the department to establish and maintain a system of internal accounting control and ensure that the system is functioning as prescribed. In addition, Section 13401(b)(2), requires the department to promptly correct weaknesses in its system of internal control when detected.

Recommendation

The department's other health coverage unit in the Recovery Branch should maintain a reliable Report of Uncleared Collections.

Delays in Refunding COBRA Overpayments

Finding

The department does not always refund the federal portion of the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA) overpayments made to Medi-Cal providers within the required 60 days. Specifically, the federal portion of identified overpayments in April, May, and June 1991 were refunded to the federal government 89, 62, and 56 days late, respectively. The overpayments, which the department was required to offset against subsequent federal reimbursements, amounted to approximately \$21 million.

Criteria

The 1985 COBRA, Section 9512, requires the department to refund provider overpayments to the Health Care Financing Administration within 60 days of discovery. Refunds are to be made through an adjustment to the federally funded portion of the department's Medi-Cal expenditures.

Recommendation

The department should promptly refund identified 1985 COBRA overpayments to the federal government.

**Federal Drug-Free Workplace Requirements
Not Fully Implemented**

Finding

The department did not fully comply with the Federal Drug-Free Workplace Act of 1988 (act) in fiscal year 1990-91. In our review of the department's compliance with the act, we found the following instances of noncompliance:

- Although the department provided a Drug-Free Workplace statement to employees once, in April 1989, it did not have an ongoing procedure to inform employees about the requirements of the act.
- The department's Drug-Free Workplace statement provided to employees did not meet the requirements of the act. Specifically, the statement did not inform employees that, as a condition of employment, they must abide by the statement. The statement also did not inform employees that they must notify the department of any drug statute conviction for a violation occurring in the workplace no later than five days after such a conviction.

In February 1992, we informed the department of the results of our review. As a result, on February 28, 1992, and March 4, 1992, the department issued revisions to its Drug-Free Workplace statement to correct the deficiencies noted during our review. The department plans to issue the revised statements to all present and future employees.

Criteria

The Federal Drug-Free Workplace Act of 1988 requires agencies to have an ongoing drug-free workplace program. It further requires all agencies to publish a Drug-Free Workplace Policy statement outlining the conditions of employment under a federal grant.

Recommendation

The department should continue to ensure compliance with the Federal Drug-Free Workplace Act of 1988.

Inaccurate Estimate of Receivables	Finding
	<p>The department did not follow state procedures in estimating receivables reported to the State Controller's Office for inclusion in the State's financial statements. The department estimated certain receivables owed to the Health Care Deposit Fund at June 30, 1991, to be approximately \$406 million. However, the department included in its estimate all receivables it expected to collect rather than only those receivables that it expected to collect in the ensuing 12 months. The State Controller's Office reports receivables that are expected to be collected in the ensuing 12 months. As a result, the amount of receivables that the department reported to the State Controller's Office as of June 30, 1991, was higher than it should have been. Our estimate of receivables that the department would collect in the ensuing 12 months is approximately \$89 million, \$317 million less than the \$406 million that the department estimated.</p>

We reported a similar weakness during our audits for fiscal years 1987-88, 1988-89, and 1989-90. In its response to our fiscal year 1989-90 management letter, dated March 12, 1991, the department stated that it would begin the process of coordinating the appropriate parties to develop procedures to properly identify receivable balances. However, the department still did not develop or use appropriate procedures to estimate receivables at June 30, 1991.

Criteria

The State Administrative Manual, Section 7620, requires the department to record receivables that it does not expect to collect within one year in a deferred account for financial statement purposes. Recording the receivables it does not expect to collect in one year in this deferred account enables the department to report as the net amounts for accounts receivable only the receivables expected to be collected within one year.

Recommendation

The department should continue its efforts to develop a system that allows the department to estimate and report at the end of the fiscal year only those receivables it expects to collect in the ensuing 12 months.

Late Financial Reports**Finding**

The department did not submit the financial reports for its portion of the State's General Fund to the State Controller's Office until August 15, 1991, 15 days after the due date. Additionally, the department needed to revise its financial reports for its portion of the State's General Fund and Federal Trust Fund. These revisions were not submitted to the State Controller's Office until January 24, and January 29, 1992, or 177 and 162 days late, respectively. Failure to submit accurate financial reports by the required deadlines delays compilation by the State Controller's Office of the financial statements for the State and may delay the issuance by the State Treasurer's Office of the official statements that accompany bond issues.

Criteria

The State Administrative Manual, Section 7990, requires state agencies to submit to the State Controller's Office by July 31 the financial reports for their portion of the State's General Fund. In addition, they must submit financial reports for all other funds by August 20.

Recommendation

The department should submit accurate financial reports to the State Controller's Office by the required due date.

Inaccurate Identification of Encumbrances**Finding**

The department did not accurately analyze its listing of payables to determine which items represented encumbrances for any of the six funds for which we reviewed encumbrances. Under generally accepted accounting principles, encumbrances are amounts committed for goods and services to be received after the end of the fiscal year. As a result of its inaccurate analysis of payables as of June 30, 1991, the department incorrectly reported encumbrances to the State Controller's Office. For example, the department reported approximately \$103.3 million in encumbrances for the General Fund, approximately \$121.7 million in encumbrances for the Cigarette and Tobacco Products Surtax Funds, and reported no

encumbrances for the Federal Trust Fund. However, we subsequently determined that the appropriate encumbrance amounts were approximately \$63.6 million, \$109.5 million, and \$8.1 million, respectively. If the department does not properly identify encumbrances in its financial reports, the State Controller's Office does not have appropriate information to prepare the State's financial statements in accordance with generally accepted accounting principles.

We reported a similar weakness in our audit for fiscal year 1989-90. In its response to our management letter, dated March 12, 1991, the department said it was revising its procedures for preparing the year-end financial statements to identify and report as encumbrances only those amounts committed for goods and services not received by June 30. However, based on our review of the department's financial statements, the weakness still exists.

Criteria

The State Administrative Manual, Section 10544, requires agencies to analyze their encumbrances to determine which are valid as of June 30 of each fiscal year.

Recommendation

At the end of the fiscal year, the department should analyze its commitments to determine whether goods and services were received before June 30 or will be received after June 30 and should correctly report as encumbrances to the State Controller's Office only those amounts committed for goods or services not received by June 30.

Incorrect Payments to Medi-Cal Providers	Finding
	The department does not always ensure that the correct amounts are paid to Medi-Cal providers. Of 74 automated Medi-Cal payments we tested, we noted the following conditions:

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- The department used an incorrect contract rate to pay invoices submitted by one provider for services provided during April through September 1990. The contract rate was increased in April 1990; however, the rate change made to the automated system did not agree with the new contract rate. As a result, the provider was underpaid approximately \$10,000. The department stated that all claims affected by the new rate would be reprocessed to reimburse the provider for the underpayment.
 - In one instance, the department paid an invoice twice. The second invoice was suspended as a duplicate payment in the automated system; however, because of an examiner error, the suspension was erroneously overridden resulting in an overpayment of approximately \$18. After we discussed this matter with the department, the duplicate payment was voided.

Criteria

The California Government Code, Section 13401, requires agencies to maintain an effective system of internal control. The State Administrative Manual, Section 8422.1, requires agencies to ensure that invoices have not been previously paid before submitting them for payment.

Recommendation

The department should ensure that correct rates are used when calculating amounts owed to Medi-Cal providers. The department should also thoroughly review claims that are suspended as duplicate payments before overriding the suspension and paying the claim.

Weaknesses in Control Over the Revolving Fund

Finding and Criteria

The department has weaknesses in its control over its revolving fund. We noted the following specific deficiencies:

- The department did not properly claim full reimbursement from the State Controller's Office for its revolving fund. As of December 1991, the department had not received

reimbursement for approximately \$63,000 in disbursements made during fiscal years 1987-88 and 1988-89 and approximately \$3,500 in disbursements made during fiscal years 1989-90 and 1990-91 because it lost the supporting documentation. The State Administrative Manual, Section 8170, provides the procedures to reimburse the revolving fund. Good accounting procedures require the revolving fund to be reimbursed promptly.

- Approximately \$40,000 of the department's salary advances made from the revolving fund and outstanding as of June 30, 1991, were more than 120 days old. At the time of our testing, the State Administrative Manual, Section 8118, required the department to collect salary advance repayments from the subsequently issued payroll warrants for the time periods covered by the salary advances. Also, approximately \$20,000 of the department's training advances outstanding as of June 30, 1991, were more than 120 days old. Failure to promptly follow-up on outstanding revolving fund advances may result in the loss of State funds if employees leave state service without repaying the advances.
- The department authorized payments from the revolving fund totaling approximately \$2,200 to five vendors, but could not provide evidence that the goods were received. For example, in one instance, the department prepaid a vendor approximately \$1,800 from the revolving fund, but could not provide evidence that the goods were received. After we brought this matter to the department's attention, a stop payment was issued on the warrant. The State Administrative Manual, Section 8422.20, requires agencies to prepare Stock Received Reports or use an approved purchase order to record receiving information at the time goods are received. When an approved purchase order is used, the person checking the goods must write the date received on the document.
- The department did not promptly remit monies to the State Controller's Office for taxes withheld from salary advances outstanding more than 30 days. Specifically, the department

did not remit taxes withheld from salary advances for the July 1990 through November 1990 pay periods until February 27, 1991. Also, the department did not remit taxes withheld from salary advances for the December 1990 through March 1991 pay periods until June 1991. The State Administrative Manual, Section 8595, requires agencies to remit federal withholding taxes to the State Controller's Office if a salary warrant used to offset the salary advance is not received by the agency within 30 calendar days following the issuance of the advance.

- We noted that the department issued duplicate payments to one vendor during 1988 because the department erroneously directed the State Controller's Office to pay the vendor after the department had already paid it from the revolving fund. As of December 1991, the department had not recovered more than \$3,400 of the approximately \$7,000 in duplicate payments. The department also issued duplicate payments totaling \$1,500 to one vendor in fiscal year 1990-91. As of December 1991, the department had not determined whether the vendor had returned the duplicate payments. The State Administrative Manual, Section 8422.1, specifies that invoices submitted to the State Controller's Office must not have been previously paid.

We reported similar weaknesses in the department's control over the revolving fund in our audit for fiscal year 1989-90. Although weaknesses still exist, the department has taken actions to improve control over the revolving fund. For example, in July 1991, the department implemented collection procedures for outstanding travel and training advances.

Recommendation

The department should ensure its compliance with each of these required controls over the revolving fund.

Weaknesses in Control Over Cash Receipts**Finding**

The department has weaknesses in its control over cash receipts. We noted the following specific deficiencies:

- The department did not always deposit cash receipts promptly. Of 30 Health Care Deposit Fund cash receipts we tested, 18 receipts of \$5,000 or more were deposited one to 8 days late. Also, of 46 General Fund cash receipts we tested, 4 receipts of \$5,000 or more were deposited one to 6 days late. We also found one receipt of more than \$50 that was deposited 2 days late and 2 receipts under \$50 that were deposited one and 17 days late. When the department does not deposit receipts promptly, an increased risk of loss exists from theft or fire.
- The department does not always record dates of receipt for cash collections. For 21 of the 46 General Fund cash receipts we tested, the department did not record the date cash collections were received. Thus, the department cannot demonstrate that receipts are being deposited promptly.

Criteria

The State Administrative Manual, Section 8030.1 requires that cash receipts exceeding \$5,000 be deposited on the day of receipt unless it is not practical to deposit them by closing time, in which case they may be deposited by the next working day. This section also requires agencies to deposit collections totaling \$50 or more within 5 working days and stipulates that agencies cannot hold any collections longer than 15 working days. Also, the State Administrative Manual, Section 8092, states that a report of collections normally will include the date of collection.

Recommendation

The department should deposit the cash receipts promptly and record the date received in the report of collections.

**Deficiencies in
Administering
State Contracts****Finding and Criteria**

The department did not always comply with the California Public Contract Code and the State Administrative Manual in establishing and maintaining contracts with vendors. Of 16 contracts we examined, for approximately \$3.1 million in services, we noted the following weaknesses:

- The department did not ensure that a contract payment was in accordance with the terms of the contract. We noted a contract that required an advance payment to be liquidated in equal amounts of \$28,000 from subsequent invoices. However, in one month the department paid the entire amount billed by the vendor without deducting any amount to liquidate the advance. The department eventually offset the amount against subsequent invoices. The California Government Code, Section 13401(b)(1), requires agencies to ensure that a satisfactory system of internal accounting controls is in place to provide effective accounting control over assets, liabilities, revenues, and expenditures.
- The department did not promptly submit its annual report of consulting contracts for fiscal year 1990-91 to the Department of General Services. Without a comprehensive listing of consulting contracts, the Department of General Services cannot monitor whether the State has only entered into contracts with qualified consultants. The Public Contract Code, Section 10359, requires agencies to annually prepare a report, which includes a list of the consulting contracts that have been entered into during the previous fiscal year. This section also requires agencies to submit a copy of the annual report to the Department of General Services within 30 working days after the end of the previous fiscal year.
- Ten of the 16 contracts were not properly approved before the contractor began work. The Public Contract Code, Section 10371(d), states that identified contracts, unless exempt, are of no effect unless and until approved by the Department of General Services. Additionally, the State Administrative Manual, Section 1209, requires agencies to submit contracts for review before the contractor begins work.

Recommendation

The department should follow the requirements of the California Public Contract Code and the State Administrative Manual in maintaining contracts with vendors.

Noncompliance With Certain Federal Requirements

Finding and Criteria

We noted the following instances where the department did not always comply with administrative requirements of the federal government:

- The department did not promptly offset an overpayment of approximately \$12,000 to a State Legalization Impact Assistance Grant provider against future invoices. The department made 11 subsequent payments to the provider before it started offsetting invoices by the amount of the overpayment. The Code of Federal Regulations, Title 45, Section 402.11, states that no unit of government may receive SLIAG funds in excess of the amount of allowable costs it incurs.
- The department overstated the amount of administrative expenditures included in the federal WIC Monthly Financial and Program Status Report for the period ended September 30, 1990, by approximately \$85,000. The Federal Office of Management and Budget, Circular A-102 revised, Subpart C, Paragraph 883A(b)(1), requires that financial reports contain accurate and reliable information.
- Vendors did not endorse one of the 60 food vouchers we examined for the WIC program. Vendor endorsements provide the department a means of analyzing the redeemed vouchers and of identifying vendors that may not be authorized to redeem food vouchers and vendors that may not be complying with all provisions of the program. We reported a similar weakness during our audit for fiscal years 1987-88, 1988-89, and 1989-90. The Code of Federal Regulations, Title 7, Section 246.12(r)(4), requires the department to identify redeemed food vouchers to specific vendors.

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- One voucher we examined for the WIC program was redeemed before the authorized date. In addition, departmental records indicate that, for each month of fiscal year 1990-91, vouchers were redeemed before the authorized issue date. This is possible because some food vouchers can be issued two to three months in advance to qualified recipients. Early redemption of vouchers impairs the department's control over vouchers. The Code of Federal Regulations, Title 7, Sections 246.12(r)(2)(i) and (ii), requires food vouchers to be redeemed on or after the authorized date.

Although individually these instances of noncompliance may not appear to be significant, they represent noncompliance with federal requirements, which are designed to ensure that the public's resources are not vulnerable to abuse.

Recommendation

The department should improve its compliance with federal requirements.

Department of Mental Health

We reviewed the financial operations and related internal controls of the Department of Mental Health (department) and the department's administration of the U.S. Department of Health and Human Services grants, Federal Catalog Numbers 93.025 and 93.992.

Costs Incorrectly Charged to Federal Grants

Finding

During our review of administrative costs and salaries, we identified more than \$280,000 in salaries, benefits, miscellaneous charges, and allocated administrative costs that the department incorrectly charged to the Alcohol, Drug Abuse, and Mental Health Services (ADAMHS) Block Grant. We also identified more than \$50,000 in similar costs that the department incorrectly charged to the State Legalization Impact Assistance Grant (SLIAG). These costs were incorrectly charged to the federal grants because the department programmed its automated accounting system to charge the costs of certain employees to the grants even though the work performed by the employees did not relate to the grants.

After our identification of these errors, the department reviewed the charges made to these grants. As a result of its review, the department also found that certain costs originally charged to the State's General Fund should have been charged to these grants. After making these adjustments, the department initiated steps in March and April 1992 to reverse net amounts of more than \$275,000 in charges to the ADAMHS Block Grant and \$23,000 in charges to the SLIAG. We will ensure these charges were appropriately reversed during our next audit.

Criteria

The United States Code, Title 42, Section 300x-3(d), requires federal block grant funds be used only to administer federal block grant funds. Further, the Code of Federal Regulations, Title 45, Section 402.11(c), requires that the reimbursement of costs not exceed 100 percent of SLIAG costs.

Recommendation

The department should monitor the programming of its automated accounting system to ensure that it only charges federal grants for the costs of employees whose time and expenses relate to the grants.

Weaknesses in Procedures for Making Cash Advances and Monitoring Cash and Expenditure Reports From Subrecipients

Finding

The department has weaknesses in its procedures for making cash advances to subrecipients. It also has weaknesses in monitoring the cash and expenditure reports from subrecipients of ADAMHS Block Grant funds. Specifically, we found the following conditions:

- The department has not established procedures to make prompt initial advances to counties. Although the department received notification of its ADAMHS Block Grant award on April 11, 1990, the department did not send applications for the counties to fill out until September 28, 1990. As a result, the department did not make the initial advances to the counties until November 27, 1990, nearly five months after the start of the fiscal year. Failure to make prompt advances may force the subrecipients to delay or cancel services at the local level.
- The department does not monitor the cash balances of subrecipients because it does not consistently reconcile its records with the reports on grant cash transactions submitted by the counties. In a sample of ten counties that received ADAMHS Block Grant funds, we found that the grant cash reports submitted by three of the counties did not reconcile to the department's records. In addition, one other county had not, as of March 26, 1992, submitted a report for the quarter ended June 30, 1991. Failure to monitor the cash balances of subrecipients may allow subrecipients to maintain balances that exceed federal limits. For example, one county reported excess cash at the end of three of the four quarters even though counties should not maintain balances that exceed federal limits. As of December 31, 1990, this county reported that it had cash on hand that represented its needs for 93 days.

We observed a similar weakness during our financial and compliance audits of the department for five of the last six fiscal years. In its March 13, 1991, response to our last audit, the department stated that it had a system to monitor the cash balances of subrecipients; however, the department also stated that a partial reorganization resulted in temporary processing delays.

- The department also does not promptly reconcile its records of cash advances made to counties with the expenditure reports submitted by the counties. For example, the department did not determine that 23 counties maintained nearly \$1.1 million in unspent ADAMHS Block Grant funds from the 1989-90 fiscal year allocations until after it made the allocations for the 1991-92 fiscal year in January 1992. Because it did not promptly reconcile the county expenditure reports with its records of advances, the department does not promptly identify unused funds that can be reallocated to other counties. Further, it cannot ensure that counties' cash balances are limited to their immediate needs.

Criteria

The Code of Federal Regulations, Title 31, Section 205.4(a), requires that cash advances to a recipient be limited to the minimum amounts needed and be timed to be in accord only with the actual, immediate cash requirements of the recipient in completing the project. The timing and amount of cash advances should be as close as is administratively feasible to the actual disbursements by the recipient for program costs. In addition, Section 205.4(e) requires that cash advances made by primary recipients to subrecipients conform substantially to the same standards as outlined above. In our opinion, proper compliance with federal requirements requires that primary recipients monitor regularly the cash balances of subrecipients.

Recommendation

The department should establish procedures so that it makes advances within a reasonable period after the start of the fiscal year. In addition, the department should consistently reconcile the cash reports submitted by the counties so that it can ensure that cash

balances are not in excess of federal regulations. Finally, the department should promptly reconcile the expenditure reports submitted by the counties so that it can determine if excess cash can be reallocated to other counties.

**Lack of Policies
To Complete
Performance
Reviews of
Subrecipients
and To Correct
Weaknesses**

Finding

Although the department conducted performance reviews of the quality and appropriateness of treatment services provided by subrecipients during the 1990-91 fiscal year, its lack of policies does not ensure that all subrecipients receive timely reviews and that significant weaknesses are corrected. Specifically, the department has not established a formal policy to define the frequency and completion dates of required performance reviews of subrecipients of ADAMHS Block Grant funds. In addition, in our review of the questionnaires the department used to conduct its performance reviews, we noted numerous issues that the department's reviewers considered significant. However, the department has not established formal policies to define the follow-up procedures to ensure that significant issues are corrected.

We reported a similar weakness in our report for fiscal year 1989-90. In its response on March 13, 1991, the department stated that it would establish policies and implement procedures to assess the effectiveness of subrecipients' performance.

On March 25, 1992, the department notified the Office of the Auditor General that it has developed a draft policy to outline the frequency of the performance reviews of subrecipients of ADAMHS Block Grant funds. At the same time, the department stated that its review policy will address the correction of weaknesses it identifies in its performance reviews.

Criteria

The United States Code, Title 42, Section 300x-4(c)(5), requires that the State agree to provide periodic independent peer reviews to assess the quality and appropriateness of treatment services provided by entities that receive funds from the ADAMHS Block Grant.

Recommendation

The department should finalize and implement policies to assess the effectiveness of subrecipients' performance and to correct significant weaknesses.

Inappropriate Payment for Uncompleted Contract

Finding

In a test of disbursements, we noted the department paid a contractor approximately \$8,600, including more than \$700 in excess of the contract amount even though the contractor did not deliver a product that met the terms of the contract. Specifically, the department approved a contract for approximately \$7,900 that required the contractor to deliver a handbook, in English and Spanish versions, that outlined the legal and constitutional rights of minors in mental health facilities throughout California. After approving the contract, the department determined the contractor had inserted a paragraph into the contract that the department did not identify before it signed the document. The paragraph that the contractor added gave the contractor the copyright on the handbook.

Subsequently, the department concluded that the contractor could not deliver a product that would meet the contract terms. Therefore, the department notified the contractor that although the work was not complete, the contract term would not be extended. However, the department agreed to pay the contractor's expenses to the date it cancelled the contract. When the contractor submitted a bill for approximately \$8,600, more than \$700 in excess of the original contract amount, the department paid the contractor even though the contractor did not deliver a product, in an English or a Spanish version, that met the contract terms. The department believes that because of various disputes with the contractor and because of the paragraph that the contractor added to the contract, it was in the best interests of the department to pay the contractor. However, the department has not adequately explained why it paid the contractor in excess of the contracted amount. Failure to ensure that contracts are properly reviewed before approving them can, as in this case, result in the State incurring unnecessary expenditures.

On October 4, 1991, the department informed the Office of the Auditor General that it has revised its procedures for monitoring contracts and contractor performance. The department also stated that it is revising the standard language to include provisions in each contract that could protect the State's interests in similar situations.

Criteria

The State Administrative Manual, Section 1225, states that all contracts should contain a provision for resolution of contract disputes. Further, Section 8422.1 requires that invoices comply with provisions of the contracts.

Recommendation

The department should ensure that contracts are carefully reviewed before approving them. The department should not pay contractors when the contractors do not meet the contract terms. Finally, the department should ensure that contract payments do not exceed the contracted amount.

Weaknesses in Control Over the Revolving Fund

Finding

The department has weaknesses in control over salary and travel advances made from the office revolving fund. Specifically, we noted the following conditions:

- The department does not consistently follow established procedures when making salary advances. For example, the department provided an employee with two regular salary warrants even though the department also paid this employee with revolving fund warrants for this same period. As a result, the department overpaid the employee more than \$3,800. The employee was overpaid for the April and May 1991 pay periods, but the errors were not identified until we questioned the payments in October 1991. In January 1992, the department was still attempting to work out a repayment schedule with the employee. However, since the employee was on disability leave, the department was unable to offset the amount from the employee's salary warrants.

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- The department has not taken effective steps to obtain travel expense claims or collect money from its employees to clear long-outstanding travel advances. As of June 30, 1991, \$32,138 or 57 percent of the total nonpermanent travel advances were outstanding for more than 60 days. Failure to reimburse the office revolving fund for travel advances may unnecessarily reduce funds available for other uses. We observed a similar weakness during our financial audit of the department for fiscal year 1989-90. In response to our previous report, the department noted that the previous weaknesses were the result of a turnover in staff and a lack of training.

Criteria

The State Administrative Manual, Sections 8595 and 8160, requires departments, after making a salary advance, to withhold an employee's regular payroll warrant and only pay the employee the difference between the payroll warrant and the amount of the previous salary advance. Further, Section 8116, requires agencies to reimburse and, therefore, clear advances from the revolving fund when employees submit travel expense claims. If the advance exceeds the employee's travel expense claim, the employee is required to reimburse the revolving fund promptly unless it is known that the employee will travel in the near future.

Recommendation

The department should ensure that it follows State Administrative Manual procedures when accounting for and collecting salary advances.

Payments to Local Government Without a Formal Agreement

Finding

During our review of Short-Doyle expenditures, we identified a series of payments to a county, totaling \$4.2 million, that were made without a formal agreement between the department and the county. Short-Doyle expenditures provide for mental health services through a partnership between the State and county. However, without a formal agreement, the department cannot ensure there is adequate support or authorization for making the expenditures.

Criteria

The Welfare and Institutions Code, Section 5707, which was applicable during fiscal year 1990-91, required that a county's Short-Doyle plan be recognized, upon approval by both parties, as a contractual arrangement between the State and the county. Further, according to the department's policy letter #90-21, an approved county plan will be the determining factor for continued funding to a county.

Recommendation

The department should ensure that agreements with counties have been formalized before it makes payments to the counties.

Department of Social Services

We reviewed the financial operations and related internal controls of the Department of Social Services (department) and the department's administration of the U.S. Emergency Management Agency grant, Federal Catalog Number 83.516; the U.S. Department of Agriculture grants, Federal Catalog Numbers 10.551 and 10.561; and the U.S. Department of Health and Human Services grants, Federal Catalog Numbers 93.020, 93.021, 93.023, 93.025, 93.026, 93.645, 93.658, 93.659, 93.667, and 93.802.

Improvement in Cash Management for Local Assistance

Finding

The department has improved its cash management system for requesting federal funds for the federal share of the department's local assistance expenditures. However, the State lost approximately \$144,300 in potential interest income. Specifically, we noted the following conditions:

- For 58 of the 158 claims for the In-Home Support Services program, the department did not promptly request federal funds to reimburse the State for expenditures that the department incurred. The department initially pays In-Home Supportive Service expenditures from the department's general fund and subsequently requests federal funds from the Social Services Block Grant to reimburse the general fund. We allowed the department five working days to request and receive reimbursement from the date the department initially paid the expenditures or from the date the department was subsequently notified that federal funds were available. After allowing for the five working days, the department was one to 185 days late in receiving reimbursement for the 58 claims. As a result, the State lost approximately \$85,500 in interest income.
- For the five claims for the Child Welfare Services program, the department did not promptly request federal funds to reimburse the State for expenditures the department incurred. For the five

claims, the department disbursed money from 2 to 328 days before receiving the federal funds. As a result, the State lost approximately \$58,800 in interest income.

We reported similar weaknesses in our financial audits for fiscal years 1985-86 through 1989-90. In its response to the audit for fiscal year 1989-90, the department said that it had implemented new procedures to increase the frequency and promptness of requesting federal funds. Further, the department acknowledged the importance of reimbursing State funds as soon as it is administratively feasible, but that to do so in five working days is not always possible.

Criteria

The State Administrative Manual, Section 0911.4, requires state agencies to secure prompt reimbursement from grant funds for goods and services provided.

Recommendation

The department should promptly request federal funds to reimburse the general fund for federally eligible expenditures.

Errors in Charging Indirect Costs to Federal Programs

Finding

The department made errors in charging indirect costs for hearings to the State Administrative Matching Grants for Food Stamps program, the Family Support Payments to States—Assistance Payments program, and the Refugee and Entrant Assistance—State Administered program for June 1991. The department allocates indirect costs of hearings based on a report of the types of hearings held in the previous month. Because the report for June 1991 was not available at the time the department performed the June allocation, the department used the May 1991 report. Once the June report became available, however, the department did not adjust the allocations. As a result, the department undercharged the federal government's share of the Food Stamps program by approximately \$19,000 and overcharged the federal government's share of the Family Support Payments to States—Assistance

Payments program and the Refugee and Entrant Assistance—State Administered program by approximately \$13,000 and \$1,400, respectively. For the remaining \$4,600, the department overcharged the State's General Fund. In March 1992, the department corrected the errors noted.

Criteria

The Office of Management and Budget, Circular No. A-87, states that to be allowable under a grant program, costs must be necessary and reasonable for the proper and efficient administration of grant programs. In addition, Circular A-87 requires that salaries and wages of employees chargeable to more than one grant program be supported by appropriate time distribution records and that the method used must produce an equitable distribution of time and effort.

Recommendation

The department should ensure that the charging of indirect costs to federal grants is based on current information.

Federal Financial Reports Not Reconciled With Accounting Records

Finding

The department did not reconcile its federal financial reports prepared during fiscal year 1990-91 with departmental accounting records. Failure to reconcile federal financial reports with the accounting records can result in misstatements of claims that may go undetected.

We reported a similar weakness in our financial audits for fiscal years 1985-86 through 1989-90. The department informed the Department of Finance that it is developing automated processes that will ensure that the data contained in federal reports is consistent with the accounting records maintained in the California State Accounting and Reporting System (CALSTARS). Further, the department projected that this process will be completed during fiscal year 1992-93.

Criteria

The Office of Management and Budget, Circular A-102 revised, Subpart C, paragraph 883(b)(1), requires grantee financial management systems to provide accurate, current, and complete disclosure of each grant program. Further, the State Administrative Manual, Section 20014, requires agencies receiving federal funds to reconcile federal financial reports with their official accounting records and retain all supporting schedules and worksheets for a minimum of three years.

Recommendation

The department should implement a reconciliation process so that a complete, prompt reconciliation can be done.

Delays in Collecting Disallowed Costs or Adjusting for Incorrectly Claimed Costs

Finding

The department did not promptly collect disallowed costs from the county welfare departments. Prior to January 1, 1992, the department contracted with the Division of Audits of the State Controller's Office to conduct audits of the administrative expenditure claims records of county welfare departments. While conducting these audits, the State Controller's Office was responsible for determining whether county welfare departments adhered to regulations and instructions set forth by the federal government and the department. The department is responsible for analyzing and resolving any audit protest between the county welfare departments and the State Controller's Office. In addition, the department is responsible for collecting from the county welfare departments the disallowed costs that the State Controller's Office identified as a result of the audits.

From September 5, 1991, to April 24, 1992, the department did not release any audits to the accounting unit so that funds could be recovered from the counties. We reviewed 10 of the 55 audits in the "application process." In the application process, staff determine the type of funding, fiscal period, program, etc., to which the disallowed costs or incorrectly claimed costs relate. After allowing time for the department to resolve any audit protest

or appeal and time to place the item in the application process, one item was in the application process for approximately 4 months before it was completed. The other nine items have been in the application process from approximately 10 months to 45 months without being completed. For the 10 test items, the amount of disallowed costs was approximately \$2.5 million and incorrectly claimed costs totaled approximately \$2.6 million. Because 9 of the 10 items are still in the application process, we are not able to determine what portion of the \$2.5 million in disallowed costs applies to federal funding.

We reported similar weaknesses in our audits for fiscal years 1985-86 through 1989-90. The department responded to our audit for fiscal year 1989-90 by stating that it will examine the application process to determine if any adjustments can be made that will benefit the process. In addition, the department stated that audit work will be re-prioritized to handle audits of large dollar amounts first. However, as of April 24, 1992, only nine audits had been released to accounting since our last review on January 11, 1991.

Criteria

The Code of Federal Regulations, Title 45, Section 74.61(h), requires the State to follow a systematic method to ensure prompt and appropriate resolution of audit findings and recommendations.

Recommendation

The department should promptly offset the disallowed costs of the county welfare departments against the current county claims or adjust for incorrectly claimed costs to ensure that excess funds are not held by the county welfare departments.

Inaccurate Report of Federal Cash Transactions

Finding

The department does not accurately prepare the quarterly report of federal cash transactions for the various programs that require this report. Of these programs, we reviewed the Foster Care Title IV-E program, the Child Welfare Services—State Grants program, the Adoption Assistance program, and the Social Security—Disability Insurance program.

The federal government requires the department to report current cumulative net disbursements of federal funds and any remaining federal funds that the department has not disbursed at the end of each quarter. The department does not net disbursements against any adjustments of previously disbursed amounts that have been returned to the department. As a result, the department did not report any excess federal funds on hand in the fiscal year 1990-91 cash report that we tested, although department records indicate cash on hand for some of these programs. Specifically, for the quarter ended June 30, 1991, the department did not report any cash on hand for the following programs: Foster Care Title IV-E, Adoption Assistance, and Social Security—Disability Insurance. However, according to the department's records, at the end of that quarter the department had approximately \$42,000 in excess federal funds for the Foster Care Title IV-E program, approximately \$500 in excess federal funds for the Adoption Assistance program, and approximately \$60 in excess federal funds for the Social Security—Disability Insurance program. We reported a similar weakness in our financial audits for fiscal years 1988-89 and 1989-90. In its response for fiscal year 1989-90, the department stated that it is considering using manual Federal grant ledgers as a means of capturing this data for reporting purposes.

Criteria

The federal Department of Health and Human Services Manual for Recipients Financed Under the Payment Management System, Section 402, states that disbursements in the federal cash transactions report should be reported as actual payments made. The Code of Federal Regulations, Title 45, Section 74.61(a), requires the grantee's financial management system to provide accurate, current, and complete disclosure of the financial results of each grant program.

Recommendation

The department should report actual cumulative net disbursements of federal funds and any excess federal funds on hand at the end of each quarter.

**Noncompliance
With Certain
Federal
Requirements**

Findings and Criteria

In the following instances, the department did not always comply with administrative requirements of the federal government:

- The department overstated the federal and state share of expenditures for the Job Opportunities and Basic Skills Training program in the financial report it submitted for the quarter ending June 30, 1991, by \$7.8 million each. The Code of Federal Regulations, Title 45, Section 74.61(a), requires that the grantee's financial management system provide accurate, current, and complete disclosure of the financial results of each grant program.
- The department did not accurately report adjustments to the administrative costs of the Family Support Payments to States—Assistance Payments program. As a result, the department understated the amount due from the federal government by approximately \$4,400. The Code of Federal Regulations, Title 45, Section 74.61(a), requires the grantee's financial management system to provide accurate, current, and complete disclosure of the financial results of each grant program.
- The department completed only four pages of the seven-page quarterly statement of expenditures for the Foster Care—Title IV-E and Adoption Assistance programs for the quarter ended June 30, 1991. Revised federal reporting instructions from the Administration for Children, Youth, and Families indicate what information to include on the quarterly statements of expenditures. Effective with the quarter ending June 30, 1990, the department is required to submit a seven-page quarterly statement of expenditures.

The federal Administration for Children, Youth, and Families estimated that the revised statement could be completed in approximately 25 hours. However, in a letter submitted to the federal government on May 14, 1990, the department claims that this estimate is inaccurate. Also, the department stated that the new report would require extensive system modifications and a

significant increase in staff time. As a result, the department would not be able to provide all the information required for the new report. We observed a similar weakness during our financial audits for fiscal years 1988-89 and 1989-90. The department stated that it was still waiting for a response to its May 1990 letter.

Although individually these deviations may not appear to be significant, they do represent noncompliance with federal regulations, which are designed to protect the public's resources from abuse.

Recommendation

The department should improve its compliance with each of the federal requirements.

Legislative, Judicial, and Executive

Office of Emergency Services

We reviewed the Office of Emergency Services' (office) administration of the U.S. Emergency Management Agency grant, Federal Catalog Number 83.516.

Delay in Requesting Administrative Fees	Finding
	<p>The office did not promptly request payment from the Federal Emergency Management Agency (FEMA) for administrative fees related to the Loma Prieta earthquake. As of June 30, 1991, the office had earned administrative fees totaling \$1.1 million. However, the office did not request payment from FEMA until February 13, 1992, when it requested \$895,000. According to an office official, the office will have made additional requests by May 15, 1992, and in the future, the office will periodically request payment of the administrative fees. When the office delays in requesting payment, it reduces the amount of state money available for other purposes. Further, we estimate that because of the delay, the State lost potential interest earnings of \$118,000 through February 1992.</p>
	<p>Criteria</p>
	<p>The State Administrative Manual, Section 0911.4, requires state agencies to secure prompt reimbursement from grant funds for goods and services provided.</p>
	<p>Recommendation</p>
	<p>The office should continue its plan to periodically request administrative fees.</p>
Delay in Appealing Denied Costs	Finding
	<p>The office has not promptly appealed the Federal Emergency Management Agency's (FEMA) denial of \$7.7 million of claimed expenses related to the Loma Prieta earthquake. During fiscal year</p>

1990-91, the office claimed \$17.7 million for public assistance administrative costs related to the Loma Prieta earthquake, of which the FEMA approved \$9.9 million. However, on February 2, 1991, the FEMA denied \$564,000 and on June 21, 1991, the FEMA denied \$7.1 million, for a total of \$7.7 million. The office plans to appeal the denials by May 29, 1992, more than 15 and 11 months, respectively after the FEMA denied the claims.

Criteria

The Code of Federal Regulations, Title 44, Section 206.228, defines eligibility criteria for state management costs. In addition, the Code of Federal Regulations, Title 44, Section 206.206, describes the process for appealing denied costs. Further, the State Administrative Manual, Section 0911.4, requires state agencies to secure prompt reimbursement from grant funds for goods and services provided. We interpret this to mean that the office should promptly appeal the FEMA's denial of its claims if it believes the FEMA erred in its determination.

Recommendation

The office should continue its plan to appeal the denied claims.

Delay in Disbursing Federal Grant Monies

Finding

The office's cash management system does not always minimize the time between the receipt of federal Disaster Assistance funds and the disbursement to applicants. For 3 of the 40 claims that we reviewed, the State held the federal funds 10 to 11 days before disbursing them to applicants. Some of this delay can be attributed to the time the State Controller's Office takes to process the disbursements. We observed a similar weakness during our audits of the office for fiscal years 1988-89 and 1989-90. However, while there were still delays in disbursing federal funds during fiscal year 1990-91, we noted that the office has significantly reduced these delays.

Criteria

The Code of Federal Regulations, Title 31, Section 205.4(a), requires that the timing and amount of cash advances be as close as administratively feasible to the actual disbursement by the recipient organization.

Recommendation

The office should continue to take measures that will minimize the time elapsed between receipt of federal funds and disbursement to applicants.

Delay Between Receipt and Return of Federal Funds

Finding

The office did not always promptly remit to the Federal Emergency Management Agency (FEMA) refunds of federal funds that applicants have not used. The FEMA bills applicants for amounts they are to refund to the FEMA. Applicants send the refunds to the office, and the office remits the refunds to the FEMA. For all three of the refunds that the office received before November 1990, the office took 37 to 40 days to remit the refunds to the FEMA. We observed a similar weakness during our audits of the office for fiscal years 1988-89 and 1989-90.

However, in November 1990 the office revised its procedures for processing refunds. For the two refunds that the office received after November 1990, the office took 7 to 9 days to remit the refunds to the FEMA. This is a significant improvement over the previous processing time.

Criteria

The Code of Federal Regulations, Title 44, Section 205.120(c), states that bills for collection are due upon receipt. We interpret this to mean that the State should promptly return to the FEMA amounts refunded by disaster applicants.

Recommendation

The office should continue its efforts to promptly remit refunds from applicants to the FEMA.

Board of Equalization

We reviewed the financial operations and related internal controls of the Board of Equalization (board).

Weaknesses in Resolving Credit Balances

Finding and Criteria

The board does not ensure that it is in compliance with the California Revenue and Taxation Code related to the unapplied credit balances on its business tax system. Consequently, in some cases, taxpayers did not receive tax refunds at the time they were entitled to receive them. However, in some other cases, the board made refunds beyond the period allowed by the code.

The California Revenue and Taxation Code, Section 6901, requires that, when the board determines that any amount collected or received from a taxpayer is not owed to the board, it must credit the taxpayer's account for any amount owed by the taxpayer and refund the balance.

However, we noted instances when the board applied a portion of a credit balance to satisfy a taxpayer's liability, notified the taxpayer that the liability was paid, and then did not send the taxpayer a refund for the balance of the credit. According to the deputy director of the Special Taxes and Operations Department, if an unapplied credit exists on the accounts receivable at the time of billing that exceeds the amount owed by a taxpayer, the excess amount will post to the accounts receivable if no other taxpayer's liability exists. Since the computer does the calculations, the person issuing the billing is not necessarily aware of the end result. He added that any residual overpayment amounts are to be reviewed when the board's collection unit periodically reviews the unapplied credits. Thus, rather than refunding the credit, as required, the board holds the credit in the unapplied credit file until the collection unit reviews the account. As discussed below, these credit balances may stay in the unapplied credit file for more than three years.

We also noted several instances when the board, in its notice of determination billings, billed taxpayers for taxes owed but did not reduce their taxes owed by the amount of the credit balances on their accounts. According to the deputy director of the Sales and Use Tax Department, the board's practice for notice of determination billings is to check for a credit before billing the taxpayer, apply the credit to the taxpayer's liability, and if it exceeds the liability, refund the balance. He added that an exception to this policy is when a taxpayer designates credits to be applied to some specific liability other than the audit or field investigation. However, for the notice of determination billings that we reviewed, the board did not always follow the practice described by the deputy director. It did not timely apply the payment or refund the balance as required by Section 6901.

For other billings, the demand for payment billings, the deputy director of the Sales and Use Tax Department stated that, on August 21, 1990, the new on-line billing program was implemented. The new on-line program alerts billers when an unapplied credit exists. The billers can then make a decision to override the warning or investigate the nature of unapplied credits. He added that the risk of not applying credits has been reduced.

When a refund is due, the California Revenue and Taxation Code, Section 6902, allows the board to make the refund for a period of up to three years after the board received the payment, unless the taxpayer files a claim within that period, thereby extending the time, or unless the credit relates to an agreement between the taxpayer and the board to extend the period (waiver).

However, we found instances when the board made refunds to taxpayers although the overpayments were more than three years old and thus beyond the board's authority to refund. According to the deputy director of the Sales and Use Tax Department, the board's practice has been to refund credits beyond the three-year period in some situations. He mentioned cases in which taxpayers filed claims or the board obtained waivers from taxpayers to extend the period. However, in the instances we reviewed, we did not find any claims or waivers that would extend the period beyond three

years. The deputy director stated that the board is currently reviewing the unapplied credits more than three years old to determine if any refunds would be precluded by the code. If any of those refunds exist, the board has asked the State Board of Control to include them in its annual appropriation bill sent to the Legislature. This will allow the board to make refunds beyond the three-year period.

These problems exist because the board does not have a policy to review and resolve unapplied credit balances within the period allowed by the code, contributing to the large number of credit balances on its business tax system. At June 30, 1991, the board had approximately 18,000 credit balances, totaling more than \$59 million. Of these, at least 785 credit balances were more than three years old. Because the board does not have a policy to resolve these credit balances within the period allowed by the code, the board cannot ensure that all taxpayers are receiving refunds at the time they are entitled to receive them. According to the deputy director, the board has a system that provides for a weekly listing of unapplied credits. He added that the intent of the process is that all of these be reviewed on a timely basis. Unfortunately, there is no supervisory system structured to ensure that all accounts are reviewed within a three-year period.

Recommendation

The board should immediately apply or refund all credit balances that it determines are tax overpayments in accordance with the Revenue and Taxation Code, Section 6901. In addition, to comply with the Revenue and Taxation Code, Section 6902, the board should stop issuing refunds against the credit balance after the period allowed by the code. Finally, to ensure that taxpayers are receiving refunds at the time they are entitled to receive them, the board should develop and implement a policy that requires the board to review and resolve all credit balances promptly before the period allowed in the code expires.

**Insufficient
Controls Over
Unapplied Credit
Balance File**

Finding

The board has insufficient controls over its unapplied credit balances within its business tax system. Specifically, we found that the board has insufficient controls to prevent taxpayers from receiving credit twice for the same payment. For example, we found two instances when each taxpayer was credited twice for the same payment because the board failed to remove from its unapplied credit file credits that were previously applied against the taxpayers' liabilities. In one instance, the board subsequently applied the credit balance to another of the taxpayer's liabilities and, thus, erroneously reduced the taxpayer's liability to the board by \$82,569. In the other instance, the board erroneously increased the amount of refund by giving the taxpayer an additional credit of \$21,955. After we brought these errors to its attention, the board proceeded to recover the erroneous credit and refund from the respective taxpayers.

In addition, we noted that the board's system does not have controls to prevent the removal of credit balances from the file without accounting for them. During our review, we noted that one of the employees in the collection unit temporarily removed an account from the unapplied credit balance file for more than 30 days. During that period, the employee did not apply the credit balance against the taxpayer's liability or refund the balance. After we brought this problem to its attention, the board applied the credit balance against the taxpayer's liability.

Without sufficient controls over credit balances, the board cannot ensure that errors and irregularities are detected and prevented.

Criteria

The California Government Code, Section 13402, requires agencies to maintain an effective system of internal accounting and administrative controls. In addition, Section 13403 requires that a system of internal control include a system of recordkeeping procedures adequate to provide effective accounting controls over assets, liabilities, revenues, and expenditures.

Recommendation

The board should implement controls to prevent taxpayers from receiving credit twice for the same payment and to prevent the removal of credit balances from the credit balance file without accounting for them.

Insufficient Backup Procedures for Electronic Data Processing System

Finding

The board currently has no access to off-site backup equipment for its electronic data processing (EDP) system that it can use if a major disaster renders the computer equipment unusable. A major shutdown of the board's EDP facilities could result in processing delays and in the loss of revenues to the State and to local governments.

In addition, the board does not have a system that maintains an uninterrupted power supply to guard its EDP system against power failures. According to a board official, its new building will have a device to guard against power failures. The board plans to move to its new building in 1993.

We reported a similar weakness related to off-site backup equipment during our financial audit of fiscal years 1987-88, 1988-89, and 1989-90. In August 1991, the board completed shifting its Timber Tax System to the Stephen P. Teale Data Center (data center). As a result of its successful completion of this project, the Department of Finance approved the board's plan to shift its central computing, network services, and data storage to the data center within five years. This data center has several options to provide backup for the EDP system. An integral part of the board's plan is to develop an Operational Recovery Plan for the critical computer applications as they are moved to the data center. The board expects that a plan will be fully developed during fiscal year 1992-93.

Criteria

The State Administrative Manual, Section 4843.1, requires each department to maintain an operational recovery plan identifying the computer applications that are critical to agency operations and the

agency's plans for resuming operations following disaster affecting those applications. These backup procedures would involve arranging for access to an alternative EDP system. The State Administrative Manual, Section 4842.11, states that a critical application of an EDP system is so important to the State that the loss or unavailability of the application is unacceptable. The State Administrative Manual, Section 4842.2, requires that the agency's physical security measures must provide for reduced loss or disruption of operational capabilities because of electrical power failures.

Recommendation

The board should continue its efforts to carry out its disaster recovery plan.

Insufficient Controls Over Changes to Computer Programs

Finding

The board's information management division has a standards manual that outlines procedures for computer programmers when they make changes to programs. However, we found that the board does not always follow its prescribed procedures for changing programs. Specifically, we found that 7 of 11 changes to individual production programs were not supported by documents showing that program changes were authorized and tested. Without these documents, the board cannot ensure that the changes to individual programs are approved by the programming manager or designee and that the programs are tested properly. Unauthorized changes to individual programs can result in errors being inadvertently included in the system or, in the extreme, fraudulent activities committed without prompt detection. Also, undocumented program changes can unnecessarily complicate the ongoing maintenance of the computer system.

Criteria

The Board of Equalization's Information Management Division manual, dated March 20, 1990, states that all program changes should be approved by the programming manager or designee. It

also states that the program change authorization will be filed in the program book, along with any supporting documentation. The California Government Code, Section 11771, requires agencies to maintain strict controls over EDP systems to prevent unauthorized access to programs and data files.

Recommendation

The board should implement its procedures to ensure that all changes to the computer programs are authorized and properly approved.

Office of the Secretary of the Health and Welfare Agency

We reviewed the Office of the Secretary of the Health and Welfare Agency's (agency) administration of the U.S. Department of Health and Human Services grant, Federal Catalog Number 93.025.

Inadequate Bookkeeping Practices for Charging the State Legalization Impact Assistance Grants

Finding

The Office of the Secretary of the Health and Welfare Agency did not accurately account for its charges to the federal State Legalization Impact Assistance Grants. Specifically, two charges to the grant were for travel that did not involve grant activity. Although these errors resulted in only minor overcharges and the agency had additional, compensating costs that it could have charged to the grant but did not, the errors indicate inadequate bookkeeping practices for charging expenses to the grant.

Criteria

The Code of Federal Regulations, Title 45, Section 402.21(b) requires the State to have accounting procedures in place that allow funds provided under the State Legalization Impact Assistance Grants to be traceable from the drawdown of funds to allowable grant costs. In addition, the California Government Code, Sections 13402 and 13403, requires departments to have a satisfactory system of internal control that includes recordkeeping procedures adequate to provide effective accounting control over assets, liabilities, revenues, and expenditures.

Recommendation

The agency should ensure that its charges to the State Legalization Impact Assistance Grants are appropriate.

Failure To Implement the State's Drug-Free Workplace Policy

Finding

The Office of the Secretary of the Health and Welfare Agency has not implemented the State's drug-free workplace policy. Specifically, the agency did not distribute the State's Drug-Free Workplace Statement to the employees administering the State Legalization Impact Assistance Grants. The policy exists both to help avoid the dangers and inefficiencies arising from substance abuse in the workplace and to demonstrate the State's compliance with the federal Drug-Free Workplace Act of 1988. Without the implementation of the policy, the agency cannot ensure that it is meeting these goals.

Criteria

The federal Drug-Free Workplace Act of 1988 directed that, in order to continue receiving federal grants and contracts, the State has to certify that it provides drug-free workplaces and issues drug-free workplace statements to its employees. The governor's Executive Order D-58-86, issued in September 1986, directed the Department of Personnel Administration, in consultation with the State Personnel Board, to develop policies and guidelines for achieving a drug-free state workplace. The Department of Personnel Administration Management Memorandum 89-05, effective on April 14, 1989, directed state departments to distribute to all affected employees Executive Order D-58-86 as well as the Drug-Free Workplace Statement that it developed to implement the executive order.

Recommendation

The agency should ensure that all affected employees receive Executive Order D-58-86 and the Drug-Free Workplace Statement.

State Treasurer's Office

We reviewed the financial operations and related controls of the State Treasurer's Office (office).

Inaccurate Bank Account Reconciliation

Finding

The office did not prepare an accurate bank account reconciliation for the centralized state treasury system. Specifically, even though the reconciliation as of March 31, 1991, balanced in total, the detail contained items that the office should have removed from the report and did not include other necessary items. Office staff were aware of some of the items that it should have removed from the report and provided us with that information.

As of March 31, 1991, the office's outstanding check listing supporting its reconciliation totaled approximately \$2.851 billion. However, the bank had already paid \$2.848 billion of the \$2.851 billion, and thus, the office should not have included these items as outstanding checks. A data compatibility problem within the office's automated system caused most of the \$2.848 billion overstatement. According to the office's manager of the bank reconciliation unit, this problem was due to the conversion of certain of the office's bank reconciliation processes from one automated system to another. Additionally, the office did not include in its outstanding check listing approximately \$259,000 of checks that were issued on or before March 31, 1991, but were paid after that date. Finally, the office should have removed at least \$20 billion of the \$21.6 billion of electronic wire transfers that were included in the reconciliation. According to the office's manager of the bank reconciliation unit, office staff did not perform the regular manual process necessary to remove cleared wire transfers from the report because they were resolving other problems with the system. Failure to prepare accurate reconciliations may result in bank or office errors going undetected.

Subsequently, we reviewed the office's reconciliation as of June 30, 1991, and found that the office had corrected many of the problems we noted during our review of the March 31, 1991, reconciliation. Specifically, the office substantially reduced the amount of errors in its outstanding check listing as well as the amount of electronic wire transfers it reported as reconciling items.

Criteria

The California Government Code, Sections 13402 and 13403, requires offices to ensure that a satisfactory system of internal accounting and administrative controls is in place to provide effective accounting controls over assets, liabilities, revenues, and expenditures. Such controls would include accurate preparation of bank reconciliations.

Recommendation

The office should ensure that it accurately prepares its bank reconciliations.

Bank Reconciliations Not Prepared Promptly

Finding

The office did not promptly prepare bank account reconciliations of the centralized state treasury system (CTS). During fiscal year 1990-91, state agencies deposited money into one of eight CTS bank accounts in seven banks. We reviewed the office's monthly reconciliations of the eight CTS bank accounts for August 1990, March 1991, and June 1991 and found that the office had prepared the reconciliations approximately two, three, and four months late, respectively.

Failure to promptly reconcile its CTS bank accounts may result in a bank or office error going undetected for a prolonged period. We observed a similar weakness during our financial audit of fiscal year 1989-90. In our previous report, dated March 1991, we stated that the office's acting fiscal officer commented that the office had been working for several years to implement an automated bank reconciliation system. We further stated that the office was having some problems fully implementing the system. The office continued to have problems implementing the system during fiscal year 1990-91.

Criteria

The State Administrative Manual, Section 8060, requires that all bank and CTS accounts be reconciled promptly at the end of each month. Further, Section 7900 requires departments to prepare all reconciliations within 30 days.

Recommendation

The office should prepare monthly reconciliations of its CTS bank accounts promptly.

Inaccurate Statement of Securities Accountability

Finding

The office did not accurately report its securities in transit account on its statement of securities accountability for June 30, 1991. Specifically, the office had not removed \$150 million from its securities in transit account although it had received the securities more than seven months before. Additionally, the office omitted a \$50 million transaction that it should have included in the account. As a result of the two errors, the office overstated assets of the Pooled Money Investment Account on the statement of securities accountability by \$100 million.

Criteria

The Government Code, Section 12320, requires the State Treasurer to receive all securities and investments belonging to the State, with certain specified exceptions. Additionally, the Government Code, Sections 13402 and 13403, requires offices to ensure that a satisfactory system of internal accounting and administrative controls is in place to provide effective accounting controls over assets, liabilities, revenues, and expenditures.

Recommendation

The office should ensure that it accurately reports assets on its statement of securities accountability.

Resources

Department of Water Resources

We reviewed the financial operations and related internal controls of the Department of Water Resources (department).

Inaccurate Reporting of Liability Accruals

Finding

The department inaccurately calculated and reported certain liability accruals for the Water Resources Revolving Fund. Specifically, the department omitted from its liability accruals employee benefits expenses for the month of June 1991 totaling \$218,000. Also, the department omitted from its accruals invoices totaling approximately \$279,000 for mobile equipment received before June 30, 1991. Additionally, because of recording errors, the department understated its claims filed by \$112,500 and understated its due to other funds account by approximately \$150,600. As a result of these errors, the department understated its accounts payable by approximately \$279,000, understated its claims filed by \$112,500, understated its due to other funds account by approximately \$369,000, and understated its expenses by approximately \$497,000. We observed similar weaknesses during our financial audit for fiscal year 1989-90.

In response to our prior year finding, the department prepared a detailed schedule of its accounts payable that identified both encumbrance and liability amounts as of June 30, 1991. This schedule is important because, under generally accepted accounting principles, expenses and liabilities should not include encumbrances, which are amounts to be paid for goods and services ordered but not received by June 30. Although the department's schedule provides more complete information with which to prepare the financial statements for the State in accordance with generally accepted accounting principles, we found that the department made a variety of errors in preparing the list. Specifically, for certain items on the list, the department doubled an invoice amount, accrued amounts that had already been paid, classified amounts as encumbrances although the related goods or services had been received as of June 30, and accrued amounts as

accounts payable that should have been classified as due to other funds. Because of these errors, the department understated its liabilities total on its accounts payable schedule by approximately \$209,000, of which approximately \$195,000 should have been classified as due to other funds.

Criteria

The State Administrative Manual, Section 10544, requires state agencies to review their records to ensure that they have accurately recorded all amounts owed to others. Additionally, the State Administrative Manual, Section 7630, defines how amounts due to other funds should be classified.

Recommendation

The department should continue its efforts to properly report liability accruals for the Water Resources Revolving Fund.

Weaknesses in Accounting for Fixed Assets

Finding

Department weaknesses in accounting for fixed assets caused errors in the department's financial statements. The effect of these errors is that the department understated its accumulated depreciation by approximately \$500,000, understated its expenses by approximately \$143,000, and overstated its retained earnings by \$357,000. We noted the following specific conditions:

- The department's computer system inappropriately deleted depreciation totaling \$140,000 for 14 light equipment items as of June 30, 1991, when the accumulated depreciation for each of the items reached \$10,000. This occurred because the department's computer program did not provide enough space in the accumulated depreciation field to accommodate depreciation for light equipment items costing \$10,000 or more. As a result, the department understated its accumulated depreciation and depreciation expense by \$140,000 at June 30, 1991. The department subsequently corrected the computer program.

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- Over the past several years, the department's computer system did not calculate depreciation totaling \$357,000 for various equipment items. The department attempted to correct this error but only corrected the portion of the error that affected current year expense. As a result, the department understated its accumulated depreciation balance and overstated its retained earnings balance by \$357,000 as of June 30, 1991.
 - The department incorrectly calculated the depreciation expense for 22 of the 45 acquisitions that we reviewed. For 12 of the acquisitions, the department did not begin depreciating the items from one to nine months after acquisition or used an incorrect purchase price when calculating the depreciation expense. For another 10 acquisitions, the department did not follow its own depreciation policy, which requires depreciation to begin in the month following the acquisition of an asset if the asset is received after the fifteenth of the month. Instead, it began depreciating the items during the month of acquisition although the department received the items after the fifteenth day of the month. As a result of these errors, some of which offset each other, the department understated depreciation expense and accumulated depreciation by approximately \$3,400 for the fiscal year ended June 30, 1991.
 - The department included inappropriate costs in the amount that it capitalized for its office refurbishment project. Specifically, the department included approximately \$22,500 of costs to acquire 159 chairs in the total of its office refurbishment account. Because the per-unit-cost of these chairs was below the \$500 unit-cost criteria set forth in state regulations, the costs should have been treated as expenses for the 1990-91 fiscal year and should not have been capitalized.

Criteria

The California Government Code, Section 13403, states that a satisfactory system of internal control includes a system of recordkeeping that provides effective accounting control over assets and expenditures. Additionally, the State Administrative Manual, Section 8616, defines depreciation as the asset's actual

cost or other basis, less the estimated residual value, distributed over the useful life of the asset. Finally, the State Administrative Manual, Section 8602, lists the conditions that must be met before property costs are capitalized as assets.

Recommendation

The department should ensure that it records all depreciation and should calculate depreciation on all of its depreciable assets based on the correct acquisition date and purchase price. Additionally, the department should follow its depreciation policy. Finally, the department should reevaluate its policy for the capitalization of office refurbishment costs to ensure that it meets state requirements regarding the capitalization of assets.

Noncompliance With State Requirements

Findings and Criteria

In the following instances, the department did not always comply with the administrative requirements of the State.

- One of the 45 claim schedules that we examined included the payment of 92 airline invoices. For 15 invoices, totaling \$4,277, the department did not match the passengers' copies of the airline tickets. The State Administrative Manual, Section 8422.114, requires employees to submit their copies of airline tickets with their travel claims so that the agency can compare these copies to the airline invoices to determine the propriety of the expenditures.
- On five invoices for vehicles for which vendors offered discounts, the department did not take advantage of discounts totaling \$2,100. The State Administrative Manual, Section 8422.1, requires that agencies ensure that cash discounts have been taken before submitting invoices for payment.

Recommendation

The department should improve its compliance with each of the state requirements.

State Water Resources Control Board

We reviewed the State Water Resources Control Board's (board) administration of the U.S. Environmental Protection Agency grant, Federal Catalog Number 66.458.

Improper Cash Management

Finding

The board does not always request federal funds for the federal share of administrative expenditures based on immediate cash needs. As a result, during fiscal year 1990-91, it maintained balances of federal funds in excess of its immediate needs. For example, based on an erroneous estimate, the board requested federal funds of \$720,000 for April 1990 expenditures when its actual needs were approximately \$155,600. The board used the funds for the federal share of administrative expenditures occurring from May through December 1990. During the remainder of fiscal year 1990-91, the board prepared five additional requests for federal funds, each of which exceeded immediate cash needs for administrative expenditures by a range of approximately \$45,000 to \$499,000.

Because the board did not properly limit its request for federal funds to its immediate needs, the federal government lost interest that it could have earned on those funds. In addition, maintaining excess cash may result in the termination of advanced financing by the federal government.

Criteria

The Code of Federal Regulations, Title 40, Section 35.3160(e)(2), allows the State to draw cash based on a schedule that coincides with the rate at which administrative expenses will be incurred. In addition, the Code of Federal Regulations, Title 31, Section 205.4(a), requires that cash advances be limited to the minimum amounts needed and that they be timed to accord with the actual and immediate cash requirements of the funded programs.

This section also stipulates that cash advances be as close as administratively feasible to the actual disbursement by the recipient organization.

Recommendation

The board should ensure requests for federal funds do not exceed its immediate cash needs.

State and Consumer Services

**Department of Consumer Affairs,
Board of Architectural Examiners,
Board of Cosmetology, and
Bureau of Electronic and Appliance Repair**

We reviewed the financial operations and related internal controls of the Department of Consumer Affairs (department), the Board of Architectural Examiners and the Board of Cosmetology (boards), and the Bureau of Electronic and Appliance Repair (bureau).

Inadequate Analysis and Reporting of Payables and Encumbrances

Finding

The department, which performs the accounting function for the boards and the bureau, did not adequately analyze the listing of amounts owed to vendors for the boards and the bureau. Specifically, the department did not correctly identify amounts as payables or encumbrances at June 30, 1990. Payables represent obligations for goods and services received on or before June 30. Encumbrances represent commitments for goods and services to be received after June 30. Also, the department did not ensure the listings included only valid amounts owed to vendors. Failure to analyze and report payables and encumbrances accurately to the State Controller's Office reduces the office's ability to prepare the State's financial statements accurately and in accordance with generally accepted accounting principles. We noted the following specific deficiencies:

- For the Board of Architectural Examiners, the department overstated encumbrances and understated payables by approximately \$954,200 because it did not correctly separate encumbrances and payables.
- For the Board of Cosmetology, the department overstated encumbrances and understated payables by approximately \$52,100 because it did not correctly separate encumbrances and payables. The department further overstated encumbrances by approximately \$4,500 because it included invalid amounts, such as amounts for goods received and paid for before

June 30. Finally, the department understated payables by approximately \$9,300 because it did not include an amount owed for goods received before year end and paid for after year end.

- For the Bureau of Electronic and Appliance Repair, the department overstated encumbrances and understated payables by approximately \$800 because it did not correctly separate encumbrances and payables. The department further overstated encumbrances by approximately \$1,000 because it included invalid amounts owed to vendors, such as amounts for goods received and paid for before year end. Finally, the department understated encumbrances by approximately \$12,000 because it did not include commitments for items it expected to receive after year end.

Criteria

The State Administrative Manual, Section 10544, requires state agencies to analyze their obligations and encumbrances as of June 30 to determine whether they received the goods and services before or after June 30. Also, the section requires state agencies to ensure they have accurately recorded all amounts owed to others.

Recommendation

The department should improve the analysis of its payables and encumbrances to determine whether goods were received or services were provided to the department before or after June 30. It should also report goods and services appropriately as payables or encumbrances. Also, the department should ensure that payables and encumbrances include all valid amounts owed to vendors.

Improper Use of the Revolving Fund

Finding

The department improperly used its revolving fund to pay some vendor invoices. For 15 of the 18 revolving fund payments we reviewed, the department made payments through revolving fund checks rather than using the normal claims processing procedure

through the State Controller's Office even though immediate payment was not necessary. The 15 payments totaled approximately \$109,000. Improper use of the revolving fund circumvents state controls over disbursements and increases the risk of misuse of state funds.

Criteria

The State Administrative Manual, Section 8110, states that permissible uses of revolving funds include paying for compensation earned, travel expenses and travel expense advances, and immediate payments when necessary. Further, the State Administrative Manual, Section 8113, states that, if time permits, agencies should always submit claims for vendor invoices to the State Controller's Office for payment by warrant.

Recommendation

The department should ensure that the revolving fund is used only for authorized purposes.

Insufficient Controls Over Accounts Receivable

Finding

The department did not establish accounts receivable for the recovery of investigative costs from licensees of the Board of Cosmetology and the bureau. Instead, the department recorded reimbursements for the board and the bureau when the board and the bureau received payments. As a result, the department understated the board's accounts receivable and reimbursements by approximately \$7,900 on its year-end financial reports. Further, the department understated the bureau's accounts receivable and reimbursements by \$600 on its year-end financial reports.

Criteria

The State Administrative Manual, Section 8776.2, requires that valid accounts receivable be accrued for reimbursements not received as of June 30.

Recommendation

The department should record as accounts receivable amounts owed for investigative costs.

**Insufficient
Controls Over
Cash****Findings and Criteria**

The department did not maintain sufficient controls over cash. We noted the following specific deficiencies:

- The department deposited collections totaling approximately \$2.3 million from one to four working days late. The State Administrative Manual, Section 8030.1, requires that agencies deposit collections totaling more than \$5,000 on the day they are received unless they are received late in the day or another reason prevents their deposit, in which case they should be deposited the next working day.
- The department overstated the cash balance by approximately \$70,000 as of June 30, 1990, by including cash receipts received in July 1990. The State Administrative Manual, Section 7620, indicates that, for financial reporting purposes, only cash on hand or cash on deposit in the State Treasury should be included in the cash accounts.
- The department did not promptly prepare its monthly general cash and revolving fund bank reconciliations. Of the 24 monthly general cash bank reconciliations for fiscal years 1989-90 and 1990-91, the department prepared 20 reconciliations between one week and six months late. Of the 17 monthly revolving fund bank reconciliations we reviewed for fiscal years 1989-90 and 1990-91, the department prepared 13 reconciliations between six weeks and four months late. In addition, one general cash bank reconciliation and three revolving fund bank reconciliations were not dated, so we could not determine if they were prepared promptly. The State Administrative Manual, Section 7900, requires that agencies reconcile bank accounts within 30 days of the preceding month.
- The department did not promptly cancel long-outstanding general cash and revolving fund checks and remit the amount of such checks to the Special Deposit Fund. In addition, the department did not send stop-payment notices to the State Treasurer's Office for checks outstanding for four years. As of June 30, 1990, the department listed checks that had been

outstanding longer than two years in its cash accounts. These checks totaled approximately \$30,400. Of this amount, \$9,300 was outstanding for four years or longer. The State Administrative Manual, Section 8042, requires agencies to cancel general cash and revolving fund checks outstanding for longer than two years and to remit the amount of these checks to the Special Deposit Fund as unclaimed moneys. In addition, this section requires agencies to send stop-payment notices to the State Treasurer's Office for general cash and revolving fund checks outstanding for four years.

Recommendation

The department should comply with the requirements contained in the State Administrative Manual to improve its control over cash.

Insufficient Controls Over Equipment

Findings and Criteria

The department did not maintain sufficient controls over equipment. We noted the following specific deficiencies:

- The department did not take a complete physical inventory of its equipment within the last six fiscal years, including fiscal year 1990-91. The State Administrative Manual, Section 8652, requires agencies to make a physical count of all property at least once every three years.
- The department did not reconcile equipment expenditures with entries in the property accounts. The State Administrative Manual, Section 7969, requires agencies to reconcile equipment expenditures with the property ledger monthly or quarterly, depending on the number of property transactions.

Recommendation

The department should comply with the requirements contained in the State Administrative Manual to strengthen its controls over equipment.

**Understatement
of Revenue
Collected in
Advance**

Finding and Criteria

The bureau received approximately \$7,900 in license fees in June 1990 for the fiscal year 1990-91 registration period. Because the bureau did not identify the fees as revenue collected in advance, the department incorrectly reported these license fees as revenue as of June 30, 1990. The State Administrative Manual, Sections 7605 and 7630, requires that revenue collected but not yet earned be reported as revenue collected in advance.

Recommendation

The bureau should identify revenue collected in advance in accordance with the State Administrative Manual.

Department of Fair Employment and Housing

We reviewed the Department of Fair Employment and Housing's (department) administration of the U.S. Department of Health and Human Services grant, Federal Catalog Number 93.025.

Inadequate Bookkeeping Practices for Charging the State Legalization Impact Assistance Grants

Finding

The department did not accurately account for its charges to the federal State Legalization Impact Assistance Grants. Specifically, for three of the five hourly payroll charges to the grant that we reviewed, the department charged an incorrect number of hours' work to the grant. In addition, the department used incorrect hourly rates in calculating each of the five payroll charges to the grant. Although these errors resulted in only minor overcharges and the department had additional, compensating costs that it could have charged to the grant but did not, the errors indicate inadequate bookkeeping practices for charging the federal grant.

Criteria

The Code of Federal Regulations, Title 45, Section 402.21(b), requires the State to have accounting procedures in place that allow funds provided under the State Legalization Impact Assistance Grants to be traceable from the drawdown of funds to allowable grant costs. In addition, the California Government Code, Section 13403, requires departments to have a satisfactory system of internal control that includes a system of recordkeeping procedures adequate to provide effective accounting control over assets, liabilities, revenues, and expenditures.

Recommendation

The department should ensure that its charges to the State Legalization Impact Assistance Grants are correctly calculated.

Franchise Tax Board

We reviewed the financial operations and related internal controls of the Franchise Tax Board (board).

Weaknesses in Resolving Credit Balances

Finding and Criteria

The board has made progress in resolving credit balances on its bank and corporation tax system; however, it still does not always review these credit balances promptly. Consequently, some taxpayers did not receive tax refunds they were entitled to receive. Moreover, in some cases, the statute of limitations prevents the board from making the refunds now.

The California Revenue and Taxation Code, Section 26071, states that if the board finds there has been an overpayment of tax for any reason, the overpayment may be credited against any amount then due, and the balance must be refunded to the taxpayer. Since the board does not automatically refund credit balances on its bank and corporation tax system, it must examine the credit balances to determine if there are any tax overpayments that must be refunded. The board maintains that it is the corporations' responsibility for keeping records of their payments and for computing their tax liabilities. Therefore, according to the board's chief legal counsel, there is no affirmative legal requirement that the board review taxpayer accounts or refund amounts if the taxpayer has not filed a claim. According to the board, it has incorporated reviewing credit balances into their normal work load and, it is attempting to review all credit balances before the statute of limitations expires.

The board's internal auditors identified the problem with credit balances in a draft audit report dated March 28, 1989. Moreover, the board has substantially completed its review of 50 taxpayers who may need refunds according to the internal auditors. As a result of its review, the board has refunded \$1.7 million and

allowed interest of \$305,000 to these taxpayers. In addition, the board has offset \$217,000 in credit balances against existing liabilities of these taxpayers. However, the board was not able to refund credit balances totaling \$820,000 because these amounts were past the statute of limitations.

During our review, we also identified other instances when reviews of credit balances were not completed promptly. For example, a corporation that we identified in September 1990 with credit balances totaling \$165,000 has not been refunded. After our inquiry in January 1992, the board agreed that the credit balances should be refunded. The board plans to issue a refund to the taxpayer in May 1992. With interest through April 20, 1992, the taxpayer is due \$217,000. The board also has not refunded two credit balances we identified in September 1991. With interest through March 31, 1992, these credit balances total \$2,300. Conversely, in another instance, the board incorrectly calculated a tax payment on a credit balance and overrefunded the corporation \$16,200.

Resolving these accounts with credit balances is critical not only because the board is paying unnecessary interest expense but also because taxpayers may be denied refunds if the accounts are not reviewed and corrected before the statute of limitations precludes the payment of the refunds. The Revenue and Taxation Code, Section 26073, states that, except for specified circumstances, no credit or refund can be allowed or made after four years from the original or extended due date of the return or one year from the date of the overpayment, whichever is later. During our review, we identified four taxpayers whose refunds could not be refunded because the statute of limitations had expired. These taxpayers would have received refunds and interest totaling \$10,500.

We reported a similar weakness in our financial audit for fiscal years 1988-89 and 1989-90. The board agreed to clarify its written procedures to state that review of credit balances should be completed before the statute of limitations expires and that any overpayments identified should be refunded or applied against existing tax liabilities. The board also agreed to include in its report

to the Legislature any credit balances it identifies that could not be refunded because they were past the statute of limitations. The board submitted this information in its report to the Legislature dated May 11, 1992.

Recommendation

The board should continue its efforts to ensure that credit balances are resolved promptly and efficiently so that taxpayers receive any refunds due before the statute of limitations expires.

Personal Income Tax System Weaknesses

Finding

The board has weaknesses in the system it uses to assess personal income taxes and issue refunds. As a result of these system weaknesses, the board overcharges some personal income taxpayers, and in other cases, makes erroneous refunds. We found the following examples of weaknesses in the personal income tax system:

- The board does not always correctly assess taxes or compute refunds for married taxpayers. In our review of 81 personal income tax accounts, we identified 3 married taxpayers that should have received refunds totaling \$8,900. For each of these married taxpayers, the wife had a credit balance on the account she used before her marriage. The wife's credit balances were not refunded because the board had posted a Notice of Proposed Assessment (NPA) to the wife's old account before her marriage. An NPA is a notice informing the taxpayer that the board believes the taxpayer owes additional tax. The NPA froze the wife's old account and prevented the automated tax system from issuing the refund. After our inquiry, the board reviewed the accounts and initiated action to refund the credit balances.
- The board does not always detect or prevent duplicate refunds that are sometimes generated by the automated and manual processing systems. For example, we identified an instance in which the automated processing system issued a refund for \$1,083,000 while, for the same taxpayer, a unit manually processed a second refund for \$762,000. Although the

automated refund had already posted to the system, the manually processed refund was subsequently approved and sent to the taxpayer. The taxpayer returned the \$1,083,000 refund, which included a duplicate refund of \$762,000 and an erroneous refund of \$321,000;

- The board did not completely correct a program error that allowed erroneous renters' credit refunds to be issued from its computer system. The board's records indicate that 124 taxpayers were overpaid a total of \$9,400. The board has issued billings to 121 of these taxpayers. The board did not issue billings to the remaining 3 taxpayers because the amounts were less than the amount it can legally collect. We reported a similar weakness in our financial audit for fiscal year 1989-90. In April 1990, the board implemented a system change it believed would prevent future erroneous renters' credit refunds; however, this change did not correct all possible situations. In January 1992, the board implemented another system change that it believes will completely correct the problem; and
- The board did not allow interest on three other refunds as required by statute. The total interest due to these taxpayers was approximately \$70.

Criteria

The California Government Code, Section 13402, requires agencies to maintain an effective system of internal accounting and administrative control. In addition, Section 13403, requires that the system of internal control include authorization procedures sufficient to provide effective control over revenues and expenditures and an effective system of internal review. The Revenue and Taxation Code, Section 19062.11, states that interest will be allowed for refunds of taxes made more than 45 days after the filing date or the date the return was filed.

Recommendation

The board should take the following actions to improve the system it uses to assess, collect, and refund personal income taxes:

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- Implement procedures to ensure that taxpayers who file joint returns are properly assessed taxes and receive their refunds;
 - Review and modify its procedures to ensure that the automated and manual systems do not issue duplicate refunds;
 - Sufficiently test all future computer programs so that potential weaknesses are identified and resolved before placing the programs into production; and
 - Review its procedures to ensure it pays interest when due to taxpayers.

Lack of Documentation To Support a Refund

Finding

The board could not locate the documentation necessary to support a refund it issued in September 1989 that was returned by the taxpayer in March 1991 to apply against other liabilities. The missing documents should support how the board calculated a refund of \$341,000. Since the board cannot locate the documentation for this refund, it cannot ensure the refund was properly calculated.

We reported a similar weakness during our financial audit of the board for fiscal year 1989-90. At that time, we reported that the board could not locate documents to support three personal income tax refunds, a corporate file to support a penalty assessment, and a nonremit extension to support cancellation of a corporate penalty assessment. After that audit, the board located all of the missing documents that it normally retains. We reviewed the documents provided by the board and found no errors.

Criteria

The California Government Code, Section 13402, requires agencies to maintain an effective system of internal accounting and administrative control. In addition, Section 13403, requires that the system of internal control include authorization procedures sufficient to provide effective control over revenues and expenditures.

Recommendations

The board should review its controls over the filing and checkout of documents to ensure that all documents are properly accounted for.

Potential Liabilities Not Disclosed

Finding

The board did not disclose two significant potential liabilities in its representation letter to the Department of Finance. For instance, the board did not provide disclosure on litigation involving the question of when diverse activities can be accounted for as a single business. In the board's response to our inquiry, the board estimates that the State's potential liability on this litigation may range from \$100 to \$500 million. The board also did not disclose another case in which judgment was entered for the taxpayer on June 13, 1991, and has since resulted in an \$11 million settlement. In spite of these potential liabilities, the board's representation letter stated that, as of June 30, 1991, there were no unasserted claims or assessments that were required to be disclosed to the Department of Finance. Without complete disclosure, the State's financial statements and the related notes may provide misleading information to Department of Finance officials and to the financial community.

We reported a similar weakness during our financial audit for fiscal year 1989-90. In its response, dated March 13, 1991, the board stated it would ensure that all significant potential liabilities are stated in its representation letter to the Department of Finance.

Criteria

The State Administrative Manual, Section 20007, requires agencies to submit a representation letter to the Department of Finance. The letter is required to include disclosure of significant loss contingencies that are required to be accrued or disclosed by the Financial Accounting Standards Board Statement No. 5, "Accounting for Contingencies."

Recommendation

The board should ensure that it discloses all material significant potential liabilities as required.

Department of General Services

We reviewed the financial operations and related internal controls of the Department of General Services (department).

Possible Liability to the Federal Government	Finding
	<p>The department has a possible liability to the federal government estimated to be as much as \$6.6 million for profits it has accumulated in its Service Revolving Fund (SRF) between July 1, 1984, and June 30, 1991. The department's SRF is an internal service fund that accounts for printing and procurement services to state agencies. The department has charged these agencies more than its costs for providing services. In turn, state agencies have passed these charges on to federal programs. The SRF accumulates profits when the department's charges for services exceed its costs. Federal regulations prohibit the State from charging federal programs for more than its costs.</p>
	<p>In 1984, the federal Department of Health and Human Services audited the State's rate-setting methods for internal service funds. As a result of the audit, the State was required to refund to the federal government approximately \$14.9 million of the profits accumulated in internal service funds. This amount represented the federal share of profits accumulated in five of the State's internal service funds from July 1, 1969, to June 30, 1984. The Department of Finance calculated that 15.5 percent of the SRF's accumulated profits of approximately \$66.8 million at June 30, 1984, resulted from charges to federal programs and, thus, the SRF owed the federal government approximately \$10.3 million.</p>
	<p>Using procedures similar to those of the Department of Finance, and using the same ratio of 15.5 percent, we estimate that, under current federal regulations, the State may owe the federal</p>

government approximately \$6.6 million.¹ This is the federal share of profits accumulated by the SRF from July 1, 1984, through June 30, 1991, after audit adjustments decreased accumulated profits by approximately \$20.8 million. However, an October 1988 proposed amendment to the federal Office of Management and Budget, Circular A-87, would allow state agencies a reasonable working capital reserve of 60 days worth of cash expenditures. This amendment, if approved, may eliminate any liability to the federal government.

However, if the department has a liability, it may not be able to reimburse the federal government because then the SRF's fund balance may be reduced to the point at which it does not have sufficient working capital to operate. The budget act for fiscal year 1990-91 required that the State Controller's Office transfer to the State's General Fund accumulated profits from the SRF of \$12 million on June 30, 1990, and \$15.3 million on June 30, 1991. Additionally, the budget acts for fiscal year 1989-90 and 1990-91 required that the State Controller's Office transfer to the State's General Fund approximately \$5.3 million in profits the SRF accumulated in its building rental account. Specifically, this accumulation occurred because the department established rental rates to pay for special repair projects on state-owned buildings. However, the department was not provided the spending authority to perform the repair projects, and it did not reduce its rental rates accordingly. These combined transfers of the SRF's accumulated profits to the State's General Fund reduced the department's working capital to approximately \$24.4 million at the end of fiscal year 1990-91. This amount is only enough to cover approximately 25 days of the department's cash expenditures in the SRF.

¹Since the federal government and the State's executive branch are ultimately responsible for negotiating any final settlement, we did not attempt to determine whether the percentage of federal participation the federal government accepted in its 1984 audit is still acceptable in 1991.

While the department is in compliance with state laws regarding its accumulation of profits in the SRF, the Department of Finance and the department have not ensured that charges to federal programs are in compliance with federal regulations.

We reported a similar finding during our financial audits for fiscal years 1988-89 and 1989-90. We recommended that the Department of Finance develop guidelines to ensure state agencies that receive services from the department exclude amounts that exceed allowable costs when charging federal programs. In his response of March 18, 1991, the director of the Department of Finance stated that, in some cases, state laws and regulations differ from those of the federal government and that the State is working with the federal government to minimize the differences. He stated that guidelines will be developed as soon as such differences are resolved.

Criteria

The federal Office of Management and Budget, Circular A-87, "Cost Principles for State and Local Governments," does not allow the State to charge federal programs for amounts that exceed costs. In addition, the California Government Code, Section 13070, provides the Department of Finance with general powers of supervision over all matters concerning the financial and business policies of the State.

Recommendation

The department should comply with the federal Office of Management and Budget, Circular A-87, when establishing billing rates for charges to state agencies receiving federal support. Further, the Department of Finance should ensure that the department complies with federal regulations. For example, compliance could be ensured by developing guidelines for the department and state agencies receiving services from the department. In addition, the Department of Finance should monitor the proposed amendment to Circular A-87 to determine the effects the amendment may have on state charges to federal programs.

**Inadequate
Control Over
Accounting
Records**

Finding

The department's Office of Local Assistance (OLA) maintained inadequate controls over its accounting records for the State School Building Lease-Purchase Fund (fund 344); the School Facilities November 1988 Bond Account, State School Building Lease-Purchase Fund (fund 776); and the School Facilities June 1988 Bond Account, State School Building Lease-Purchase Fund (fund 789). We reported similar weaknesses during our financial audit for fiscal years 1987-88, 1988-89, and 1989-90. We identified the following deficiencies:

- The records in which the OLA records expenditures and remaining spending authority for fund 344 do not agree with similar records maintained by the State Controller's Office. As of June 30, 1991, the records of the OLA differed from the records of the State Controller's Office by approximately \$6 million. Although the OLA maintains listings of these differences between the OLA and the State Controller's Office, the OLA has not evaluated the listings to determine which records are in error. These differences occurred because in past fiscal years, the OLA and the State Controller's Office recorded transactions incorrectly and the OLA failed to bring the errors to the attention of the State Controller's Office.
- The OLA's subsidiary project cards, which document the detailed funding history of each project, do not reconcile with expenditure totals posted to the general ledger for each project. We found that for 30 of 184 projects we tested, the OLA did not record in its general ledger certain grant awards and did not record all grant payments that had been cancelled. The OLA had not previously identified these recording errors because it does not reconcile its subsidiary project cards with its general ledger account balances. As a result, the account balances at June 30, 1991, were incorrect. For example, fund 344's due to local governments account balance was overstated by approximately \$2.4 million, fund 776's by \$9.1 million, and fund 789's by \$4.2 million. When we brought this to its attention, the OLA corrected its general ledger and submitted corrections to the State Controller's Office for these errors. The

OLA has contracted with the Department of Finance for assistance in reconciling its project ledger cards with its general ledger through June 30, 1990, and, for more recent reconciliations, through June 30, 1991. The Department of Finance estimates that it will complete these reconciliations by December 1992.

- The OLA cannot provide supporting documentation for approximately \$6.2 million in fund 344's due to local governments account balance at June 30, 1991. As a result, the department cannot be sure the general ledger's expenditure balance, the due to other governments account balance, and the remaining spending authority for fund 344 are accurate.
- The OLA did not record in its accounting records or report to the State Controller's Office approximately \$14 million of interest earned by school districts on lease-purchase funds not yet spent. Specifically, the OLA did not follow its prior year procedure of deducting this interest from the amount of lease-purchase funding the school districts have yet to receive. As a result, the amount of money due to local governments that the OLA reported to the State Controller's Office in its year-end financial statements was overstated by approximately \$14 million. (See Item 3 for further discussion about identifying and reporting interest earned on deposits of school districts.)
- The OLA has exceeded its spending authority for fund 344. As of June 30, 1991, the department's total commitments to school districts was approximately \$101 million. However, the funds available in fund 344 to meet these commitments totaled only approximately \$66 million. Unless the OLA acquires funds from other sources, it will not be able to meet its existing commitments to aid school districts in building new schools and modernizing existing facilities.

Criteria

The California Government Code, Section 13401, requires agencies to maintain an effective system of internal control. In addition, the Government Code, Section 13403, requires that the

system of internal control include recordkeeping procedures sufficient to provide effective accounting control over assets, liabilities, revenues, and expenditures. Furthermore, the State Administrative Manual, Section 7800, requires subsidiary ledgers to be reconciled with the general ledger each month, and the State Administrative Manual, Section 7900, discusses the importance of making regular reconciliations. Properly prepared reconciliations represent an important element of internal control because they provide a high level of confidence that the transactions have been adequately recorded and that the financial records are complete. Finally, the California Code of Regulations, Title 2, Section 1865.52, requires that the OLA collect the interest earnings from the school districts by either applying the amount of interest earned towards the state's share for funding the project or by collecting the interest as a direct remittance from the school districts.

Recommendation

The OLA should promptly evaluate and correct any posting differences between its records and the records of the State Controller's Office. Additionally, the OLA should reconcile its subsidiary project cards with its general ledger every month. Finally, the OLA should promptly record in its accounting records and should report to the State Controller's Office any interest earnings from school districts' deposits of lease-purchase funds.

Inadequate Procedures for Identifying and Reporting Interest Earned on Deposits of School Districts

Finding

The department's Office of Local Assistance (OLA) does not have adequate procedures to identify and report interest earned by school districts on funds received from the State for participating in the state school building lease-purchase program.

The OLA provides grants to school districts for construction projects under the lease-purchase program. Frequently, the OLA disburses the grant funds to school districts before the school district actually begins the construction project. In turn, school districts deposit the funds into their county treasuries' interest bearing accounts. The county offices of education should report to

the OLA the interest earnings on the school districts' deposits. The OLA's procedure in the past has been to deduct the reported interest from the amount of lease-purchase funding the school districts have yet to receive. We discuss in Item 1 the impact of the OLA's failure to record these deductions. In addition, we noted the following conditions regarding the process the OLA uses to identify and report these interest earnings:

- The OLA does not require that county offices of education promptly report the interest earned on the deposits of school districts. For example, based on the OLA's records, Los Angeles County has not reported interest earnings since June 1989, even though school districts in the county received grant funds during this period. Yet, other districts that reported interest in the past had their grants reduced by the amount of interest earned. According to the California Code of Regulations, interest payments are due and payable each September 15. Without the information from the county offices, the OLA does not know how much to offset in its future payments to the school districts.
- The OLA does not require that the county offices of education report the interest on a standard form. As a result, the reporting style and detail varies from county to county, thus requiring additional staff time to process the reports. Furthermore, under current reporting procedures, the OLA does not always receive the information necessary from these county offices to accurately determine which fund and project the reported interest relates to.
- The OLA does not employ reasonable controls to ensure that the county offices of education report the correct amount of interest earnings. For example, the OLA does not require a signature of certification from a county official attesting that the amount of reported interest is complete and correct, nor does the OLA require an independent county treasury report or bank statement to support the amount of interest reported. Instead, it is the OLA's practice to identify any unreported interest earnings through a field audit performed by the State

Controller's Office of the districts' construction costs after the projects are completed. However, as of May 1992, the records of the OLA show that school districts completed 863 projects during fiscal years 1987-88 through 1990-91, and records of the State Controller's Office show that only 31 projects (less than 4 percent) had been audited.

Because the OLA does not require prompt and accurate interest reporting, the State may be paying more for construction projects than is required, thereby diminishing the availability of funds to approve new projects.

Criteria

The California Code of Regulations, Title 2, Section 1865.52, states that interest earnings on school districts' deposits are due and payable on September 15 following the date of the execution of the lease-purchase agreement and on each successive September 15 thereafter during the life of the agreement.

The California Government Code, Section 13401, requires agencies to maintain an effective system of internal control. In addition, the California Government Code, Section 13403, requires that the system of internal control include recordkeeping procedures sufficient to provide effective accounting control over assets, liabilities, revenues, and expenditures.

Recommendation

The OLA should establish procedures to ensure that the county offices of education promptly and accurately report the amount of interest earned on deposits of school districts.

Weaknesses in Accounting for the Telecommuni- cations Division's Inventory

Finding

Procedures of the department's Telecommunications Division (division) do not ensure the department accurately records or reports its inventory. For example, the division's method of pricing inventory does not result in a recorded value that reflects the actual costs of the inventory on hand. In addition, the division does not have adequate procedures to ensure that discounts on inventory

purchases are taken at the highest rate the department's Office of Procurement negotiated. Furthermore, the division did not properly separate duties during the inventory count at its central warehouse. We reported similar weaknesses in the division's procedures for recording and reporting inventory during our financial audits for fiscal years 1988-89 and 1989-90.

After its staff counts and prices items for the annual physical inventory, the division notifies the accounting office of the new inventory balance. Using this information, the accounting office records the change from the previous year's balance. Because the department does not have a system that informs the accounting office of changes in the inventory account throughout the year, the accounting office relies entirely on the accuracy of the division's inventory balance for the amount it reports in the financial statements for the Service Revolving Fund. However, we have the following concerns regarding the process the division used to compute the inventory balance:

- The division's method of pricing does not result in a recorded value that reflects the actual cost of the inventory on hand. The division's automated inventory system for its central warehouse calculates a value for each inventory item based on the item's average purchase price. Because the purchases are entered into the system from the purchase orders, the unit prices used to calculate the average purchase prices do not always include sales tax, freight, and vendor discounts.
- The division does not have adequate procedures to ensure that discounts on inventory purchases are taken at the highest rate the department's Office of Procurement negotiated. For example, in one case, the Office of Procurement negotiated a purchase agreement with one vendor allowing a 25 percent discount on all orders for more than \$50. The Office of Procurement issued a state price schedule reflecting this agreement effective January 1, 1990. However, for the next 18 months, the division continued to pay this vendor for its purchases based on discounts of only 15 to 20 percent. Furthermore, we noted that the division incorrectly valued its inventory based on the 25 percent discount rather than the

discounts actually taken. After we informed the division of this error, the division reviewed its records and determined that the vendor owed the State of California \$44,343.

- The division did not properly separate the custodial and recordkeeping duties during the inventory count at its central warehouse. The supervisor of the warehouse was also in charge of the inventory count. Thus, this person was responsible for overseeing the custody of the inventory and for maintaining the inventory records. Furthermore, during the inventory count, this person received the count sheets, performed the test counts, and reconciled the count sheets to the automated inventory system. This failure to separate duties can result in errors or irregularities that may go undetected.

Criteria

The California Government Code, Section 13401, requires agencies to maintain an effective system of internal control. In addition, the California Government Code, Section 13403, requires that the system of internal control include recordkeeping procedures sufficient to provide effective accounting control over assets, liabilities, revenues, and expenditures. Further, generally accepted accounting principles prescribe that inventories be recorded at the cost of acquiring the inventories. Finally, the State Administrative Manual, Section 8652, states that the custodian of the property records will not exclusively control inventories and that the person in charge of the stockroom will not be in charge of maintaining the inventory records or the taking of physical inventories.

Recommendation

The department should use a consistent, documented method of pricing inventory to ensure the recorded inventory reflects the acquisition costs. Additionally, the department should establish procedures to ensure discounts are taken at the rates the Office of Procurement negotiated. Finally, the department should ensure that the division assigns duties among its employees to properly separate duties during the division's inventory count. If necessary, the division should use employees from units other than the division to properly separate duties.

Inaccurate Analysis and Reporting of Payables and Encumbrances**Finding**

The department's Office of Local Assistance (OLA) did not accurately analyze and report to the State Controller's Office its encumbrances at June 30, 1991. Encumbrances are the portion of payables that represent commitments for goods and services ordered but not received by year end. The OLA understated the amount of encumbrances it reported at June 30, 1991, by approximately \$1.2 billion for six of its bond funds that provide lease-purchasing funding to school districts for acquiring and building new schools. Specifically, the encumbrances for fund 708 were understated by \$544.3 million; for fund 774, \$446.9 million; for fund 776, \$139.8 million; for fund 739, \$12.4 million; for fund 344, \$10.5 million; and for fund 789, \$3.6 million.

Failure to analyze and report encumbrances accurately to the State Controller's Office reduces the ability of the State Controller's Office to prepare the State's financial statements accurately on a budgetary basis and in accordance with generally accepted accounting principles. For example, if we had not identified these errors, the State's reported total fund equity could have been understated by approximately \$1.2 billion.

Criteria

The State Administrative Manual, Section 10544, requires state agencies to review their records at June 30 to ensure that they have accurately analyzed and recorded all amounts owed to others. In addition, State Administrative Manual, Section 7952, provides agencies the guidance necessary to properly report encumbrances to the State Controller's Office in its year-end financial reports.

Recommendation

The OLA should report encumbrances to the State Controller's Office in accordance with the State Administrative Manual.

Insufficient Accountability Over Fixed Assets**Finding**

The department's Office of Local Assistance (OLA) needs to improve its accountability over fixed assets in the State School Building Aid Fund. Specifically, the OLA did not perform monthly

or quarterly reconciliations of fixed asset expenditures with the fixed asset ledger system (property ledger) during fiscal year 1990-91. While the OLA's general ledger showed total fixed asset expenditures during fiscal year 1990-91 of approximately \$16.1 million, the property ledger showed an increase of approximately \$24.8 million for the same period. In addition, the OLA has not completed its reconciliations of fixed asset expenditures for prior years. Unless these reconciliations are prepared, the fixed asset information in the property ledger is unreliable.

We also reported this weakness in fiscal years 1988-89 and 1989-90. The department's internal audit unit completed a review of the department's internal control structure in effect as of September 20, 1991. In its report dated October 1991, it addressed this weakness and stated that the OLA is completing these reconciliations monthly for fiscal year 1991-92. It also stated that the prior years' reconciliations are ongoing.

Criteria

The State Administrative Manual, Section 7969, requires agencies to reconcile equipment expenditures with the property ledger either monthly or quarterly, depending on the number of its property transactions.

Recommendation

The OLA should prepare reconciliations between equipment expenditures and the increase in the fixed asset account balance for the current fiscal year. It should also reconcile prior fiscal years as quickly as possible to identify any errors or omissions in the fixed asset account balance.

Delays in Returning Unencumbered Balances in the Architecture Revolving Fund

Finding

As in previous years, the department has not always returned unencumbered funds to depositing agencies within the time required by the California Government Code. Delays in returning unencumbered balances to the depositing agency delay the availability of the funds for appropriation by the Legislature.

The Legislature appropriates funds for construction projects from the funds of agencies that will benefit from the projects. The agency receiving the appropriations then transfers the funds to the Architecture Revolving Fund (ARF). Within three months after the project is completed or within three years after the initial transfer of the funds, the department is required to return any unencumbered balances to the agency that received the original appropriation.

We reviewed 30 completed projects to determine if the department promptly returned unencumbered funds to agencies. For 28 of the 30 projects, the department took more than three months to three and one-half years to return unencumbered funds for the completed projects. In 14 of the 28 instances, the department requested the return of funds from the ARF within the required three months. However, the State Controller's Office and the Department of Finance took up to three months to process the requests.

Further, the department does not always return unencumbered funds within three years from the time the funds are originally transferred to the ARF. The department did not return unencumbered funds promptly for 9 of the 17 projects we reviewed for which funds were transferred to the ARF before June 30, 1988. The department was up to one year late before it returned the unencumbered funds for 5 of the 9 projects. For 2 of these 5 projects, the department requested the return of funds within the required three years. However, the State Controller's Office and the Department of Finance took approximately one to three months to process the requests. For the remaining 4 of the 9 projects, the department has not yet processed the return of funds or obtained the approval of the Department of Finance to retain the funds for more than three years.

During our financial audits of the department for the last seven years, we reported similar delays in returning unencumbered funds within the three-month limit. Additionally, for the last four years, we reported similar delays in returning unencumbered funds within the three-year limit. The department implemented procedures in March 1987 to reduce delays in returning unencumbered balances.

Criteria

The California Government Code, Section 14959, requires the department to transfer unencumbered balances of the Architecture Revolving Fund to the original appropriation within three months after the project is completed or within three years from the time that the funds were originally transferred to the Architecture Revolving Fund.

Recommendation

The department should ensure it returns unencumbered balances within the time limits required by the California Government Code.

Inaccurate Analysis and Reporting of Emergency Classroom Encumbrances

Finding

The department's Office of Local Assistance (OLA) did not accurately analyze and report to the State Controller's Office the encumbrances for its emergency classroom program at June 30, 1991. Encumbrances are the portion of payables that represent commitments for goods and services ordered but not received by year end. The OLA overstated the amount of encumbrances it reported for its emergency classroom program by approximately \$3 million at June 30, 1991. This occurred because the OLA reported encumbrances based on purchase estimates instead of actual purchase orders. Furthermore, we noted that the OLA did not reduce the encumbrances it reported to reflect the actual amount of goods or services remaining to be received. For example, for three of the items we reviewed, the OLA encumbered approximately \$3.1 million at year end. However, our review of the outstanding purchase orders at year end showed that only \$347,426 in goods or services had not been received. As a result, approximately \$2.7 million was not available to the OLA to spend for other uses in its emergency classroom program.

Failure to analyze and report encumbrances accurately to the State Controller's Office reduces the ability of the State Controller's Office to prepare the State's financial statements accurately on a budgetary basis and in accordance with generally accepted accounting principles. Furthermore, overstating encumbrances reduces the availability of funding for other purposes.

Criteria

The State Administrative Manual, Section 10544, requires state agencies to review their records at June 30 to ensure that they have accurately analyzed and recorded all amounts owed to others.

Recommendation

The OLA should report encumbrances to the State Controller's Office in accordance with the State Administrative Manual. Furthermore, the OLA should encumber amounts in its emergency classroom program based on purchase orders rather than purchase estimates. It should review these purchase orders at year end to ensure that the reported encumbrances accurately reflect the amount of goods or services ordered but not yet received.

Inaccurate Reporting of Liabilities in the Architecture Revolving Fund and the Service Revolving Fund

Finding

The department did not properly analyze and report some of the liabilities in the Architecture Revolving Fund (ARF) and the Service Revolving Fund (SRF). We found the following specific conditions:

- In total, the department overstated its liabilities for the ARF by a net amount of approximately \$827,000. Specifically, the department did not identify approximately \$687,000 owed to contractors for services received before June 30, 1991. Moreover, it incorrectly included in its liabilities approximately \$1,043,000 for services that had already been accrued at year end and approximately \$471,000 for services that had already been paid before June 30, 1991.
- The accounting unit of the Office of State Printing overstated its liabilities for the SRF by approximately \$275,000. The accounting unit incorrectly included in its liabilities approximately \$101,000 for goods and services paid for before June 30, 1991, and approximately \$174,000 for goods and services received after June 30, 1991.

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- The department incorrectly identified in its SRF approximately \$206,000 as accounts payable when it should have classified this amount as due to other governments.

Failure to analyze and report liabilities accurately to the State Controller's Office reduces the ability of the State Controller's Office to prepare the State's financial statements accurately. We reported a similar finding in our financial audit for fiscal year 1989-90.

Criteria

The State Administrative Manual, Section 10544, requires state agencies to review their records to ensure that they have accurately recorded all amounts owed to others. In addition, the State Administrative Manual, Section 7630, requires state agencies to report amounts payable to other state agencies as "Due to Other Funds."

Recommendation

The department should analyze all documents available to identify and record its liabilities accurately. Additionally, the department should not include amounts owed to other state agencies in its accounts payable balance at year end.

Public Employees' Retirement System

We reviewed the Public Employees' Retirement System's (PERS) compliance with federal and state regulations in administering the Statewide Cost Allocation Plan (SWCAP) and its compliance with state regulations in administering the Prorata Allocation Plan (Prorata).

**Errors in
Expenditure
Data Reported
to the
Department of
Finance**

Finding

The PERS made errors in accumulating its SWCAP and prorata costs related to health benefits for retired annuitants for fiscal year 1990-91 and in reporting these costs to the Department of Finance. The PERS understated the SWCAP expenditures for health benefits for retired annuitants by approximately \$111,000 and understated the prorata expenditures by approximately \$110,000. The inaccurate data were a result of errors made by PERS staff when calculating expenditures to include in their central service costs. These errors could result in the undercollection from the federal government of approximately \$9,500 and undercollection from the State's special funds of approximately \$35,200.

Criteria

The federal Office of Management and Budget, Circular A-87, requires the State to charge the federal government only for allowable costs. In addition, the State Administrative Manual, Section 8752, requires state agencies to recover full costs for goods or services provided for other state agencies.

Recommendation

The PERS should report the corrected expenditures for the health benefits for retired annuitants to the Department of Finance so that the Department of Finance can include the adjustments in the SWCAP and prorata for fiscal year 1992-93. Further, the PERS should ensure that the expenditures it reports to the Department of Finance for health benefits for retired annuitants are accurate.

Youth and Adult Correctional

Board of Corrections

We reviewed the financial operations and related internal controls of the Board of Corrections (board).

Understatement of Liabilities

Finding

The board understated its liabilities in its financial reports for fiscal year 1990-91 for two of its capital expenditure funds. Specifically, the board did not accrue at year end all of the State's share of construction costs incurred by counties through June 30, 1991, for the construction of county jail facilities. As a result, the board understated its due to local governments account and its expenditure account by approximately \$11,290,100 in its 1988 County Correctional Facility Capital Expenditure and Youth Facility Bond Fund. It also understated these same accounts by approximately \$4,954,700 in its 1986 County Correctional Facility Capital Expenditure Fund. However, based on our review, the Department of the Youth Authority (department), which performs the accounting functions for the board, informed the State Controller's Office of the understatements in the board's accounts.

Criteria

The State Administrative Manual, Section 10445, requires agencies to record amounts owed to local governments when the liability is incurred.

Recommendation

The board should ensure that its financial reports include all amounts owed to local governments.

Checking Account Reconciliations Not Prepared Promptly	Finding The department did not complete its final reconciliation of the board's general checking account as of June 1991 until November 1991, more than two months after it submitted the board's financial reports for fiscal year 1990-91 to the State Controller's Office. Failure to promptly complete the reconciliation of the general checking account could cause errors to go undetected and could result in inaccurate or incomplete financial reports.
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Criteria

The State Administrative Manual, Section 8060, requires agencies to reconcile all bank and centralized state treasury system accounts promptly at the end of each month.

Recommendation

The department should ensure that it prepares the board's reconciliations promptly.

Department of Corrections

We reviewed the financial operations and related internal controls of the Department of Corrections (department).

Inaccurate Financial Reports

Finding

The department did not accurately prepare its financial reports for fiscal year 1990-91 for its 1988 Prison Construction Fund, 1990 Prison Construction Bond Fund, or its General Fund for its Parole and Community Services Division. During our audit, we noted the following conditions:

- The department did not accurately analyze and report its encumbrances at June 30, 1991. Encumbrances are the portion of accounts payable and due to other funds that represent goods and services ordered but not received by June 30. For its 1988 Prison Construction Fund, the department understated encumbrances in its accounts payable account by \$4,113,100 and overstated encumbrances in its due to other funds account by \$1,612,700. For its 1990 Prison Construction Bond Fund, the department overstated encumbrances in its accounts payable account by approximately \$139,400.
- The department also understated its accounts payable and expenditure accounts at June 30, 1991. For its 1988 Prison Construction Fund, the department understated these accounts by approximately \$200,800. For its 1990 Prison Construction Bond Fund, the department understated these accounts by approximately \$347,000.
- Finally, the department incorrectly posted the revolving fund adjusting entry at year end to its General Fund for the Parole and Community Services Division. As a result, the department overstated expense advances and accounts payable by approximately \$932,000.

After we notified the department of the errors in its financial reports, the department submitted the necessary adjustments to the State Controller's Office.

Failure to accurately analyze and report financial information to the State Controller's Office reduces the ability of the State Controller's Office to prepare the State's financial statements accurately and in accordance with generally accepted accounting principles.

Criteria

The State Administrative Manual, Section 10544, requires agencies to analyze their encumbrances at June 30 and to determine whether they received the goods and services before or after June 30. Section 10544 also requires agencies to record all accounts payable and expenditures at June 30 that had not been otherwise recorded by that date. Finally, the State Administrative Manual, Section 10537, instructs agencies to make an adjusting entry at June 30 to properly state accounts affected by revolving fund transactions. This section also provides guidance on how to make the entry.

Recommendation

The department should ensure that its financial reports are complete and accurate.

Department of the Youth Authority

We reviewed the Department of the Youth Authority's (department) administration of the U.S. Department of Agriculture grants, Federal Catalog Numbers 10.533 and 10.555.

Inaccurate and Incomplete Meal Count Records

Finding

The department did not ensure that all of its facilities properly counted, reported, or documented the number of meals they served that were eligible for reimbursement under the federal School Breakfast Program and the National School Lunch Program. Specifically, at the Southern Reception Center (center), we reviewed the documentation supporting 48 meal counts totaling 10,779 breakfasts and 12,010 lunches. In its reports to the department, the center overstated the number of eligible breakfasts and lunches it served by 2,858 and 1,940, respectively. As a result, for the days we reviewed, the department overcharged the School Breakfast Program and National School Lunch Program by approximately \$6,200. According to the department's acting food administrator, the overstatement occurred because, in its reports to the department, the center based its meal counts on its daily census rather than on its actual count of eligible meals served. Because this condition existed throughout fiscal year 1990-91, the total overcharge to these programs may be much greater. In addition, before December 1991, the center did not ensure that its count of meals eligible for reimbursement included only meals that it served to wards under 21 years of age. However, in December 1991, the center started listing each ward's birthdate on the meal count records so that each ward's age can be determined.

Criteria

The Code of Federal Regulations, Title 7, Sections 210.7 (c) and 220.9 (a), limits an agency's claim for reimbursement to the actual number of eligible meals it served. In addition, Sections 210.20 (b) and 220.13 (b) require agencies to maintain records to demonstrate compliance with program requirements.

Recommendation

The department should ensure that its meal counts are accurate and properly reported and that it maintains appropriate supporting records. In addition, the department should determine the effect of basing its claim on the Southern Reception Center's daily census rather than on the center's actual count of eligible meals served and revise its claims for reimbursement accordingly.

**Report on Compliance
With Federal Grant Requirements**



Kurt R. Sjoberg, Auditor General (acting)

State of California
Office of the Auditor General
660 J Street, Suite 300, Sacramento, CA 95814
Telephone : (916) 445-0255

Independent Auditors' Report

Members of the Joint Legislative Audit Committee
State of California

We have audited the general purpose financial statements of the State of California as of and for the year ended June 30, 1991, and have issued our report thereon dated December 20, 1991.

We have also audited the State of California's compliance with the requirements governing types of services allowed or not allowed; eligibility; matching, level of effort, or earmarking; reporting; special tests and provisions; federal financial reports and claims for advances and reimbursements; and amounts claimed or used for matching that are applicable to each of its major federal financial assistance programs, which are identified in the accompanying schedule of federal assistance, for the year ended June 30, 1991. The Department of Finance and state management are responsible for the State's compliance with those requirements. Our responsibility is to express an opinion on compliance with those requirements based on our audit.

We conducted our audit of compliance with those requirements in accordance with generally accepted auditing standards, *Government Auditing Standards*, issued by the Comptroller General of the United States, and Office of Management and Budget's (OMB) Circular A-128, *Audits of State and Local Governments*. Those standards and OMB Circular A-128, require that we plan and perform the audit to obtain reasonable assurance about whether material noncompliance with the requirements referred to above occurred. An audit includes examining, on a test basis, evidence about the State of California's compliance with those requirements. We believe that our audit provides a reasonable basis for our opinion.

The scope of our audit did not extend to programs administered by the University of California because the University of California contracts with independent certified public accountants for a financial and an OMB Circular A-133 audit. In addition, our audit of charges made by subrecipients of federal funds was limited to a review of the State's system for monitoring those subrecipients because subrecipients have OMB Circular A-128 audits or OMB Circular A-133 audits performed by independent auditors.

In connection with our audit of the State of California's general purpose financial statements and with our consideration of the State's control structure used to administer federal financial assistance programs, as required by OMB Circular A-128, we selected certain transactions applicable to certain nonmajor federal financial assistance programs for the year ended June 30, 1991. As required by Circular A-128, we have performed auditing procedures to test compliance with the requirements governing types of services allowed, eligibility, and special tests and provisions that are applicable to those transactions. Our procedures were substantially less in scope than an audit, the objective of which is the expression of an opinion on the State's compliance with these nonmajor requirements. Accordingly, we do not express such an opinion.

Further, we have applied procedures to test the State of California's compliance with the following requirements applicable to each of its major federal financial assistance programs, which are identified in the schedule of federal assistance, for the year ended June 30, 1992: political activity, Davis-Bacon Act, civil rights, cash management, relocation assistance and real property acquisition, federal financial reports, allowable costs/cost principles, Drug-Free Workplace Act, and administrative requirements.

Our procedures were limited to the applicable procedures described in the Office of Management and Budget's (OMB), *Compliance Supplement for Single Audits of State and Local Governments*. Our procedures were substantially less in scope than an audit, the objective of which is the expression of an opinion on the State of California's compliance with the requirements listed in the preceding paragraph. Accordingly, we do not express such an opinion.

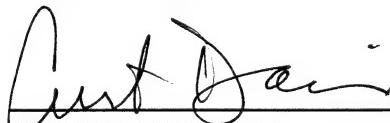
With respect to the items tested, the results of those procedures disclosed no material instances of noncompliance with the general and specific requirements identified. With respect to the items not tested, nothing came to our attention that caused us to believe that the State of California had not complied, in all material respects, with those requirements. However, the results of our audit procedures disclosed immaterial

instances of noncompliance with those requirements. We discuss those instances of noncompliance and present recommendations to correct them on pages 55 through 274 of our report. Additionally, beginning on page 325, we present a schedule listing instances of noncompliance that we consider to be minor. The instances of noncompliance identified in the State's single audit report for fiscal year 1989-90 that have not been corrected are included in the section beginning on page 55. We considered these instances of noncompliance in forming our opinion on compliance, which is expressed in the following paragraph.

In our opinion, the State of California complied, in all material respects, with the requirements governing types of services allowed or unallowed; eligibility; matching, level of effort, or earmarking; reporting; special tests and provisions that are applicable; federal financial reports and claims for advances and reimbursements; and amounts claimed or used for matching that are applicable to each of its major federal financial assistance programs for the year ended June 30, 1991.

This report is intended for the information of the California State Legislature, including the Joint Legislative Audit Committee, and the management of the executive branch. This restriction is not intended to limit the distribution of this report, which, upon acceptance by the Joint Legislative Audit Committee, is a matter of public record.

OFFICE OF THE AUDITOR GENERAL



CURT DAVIS, CPA
Deputy Auditor General

May 8, 1992

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**Report on the
Schedule of Federal Assistance**



Kurt R. Sjoberg, Auditor General (acting)

State of California
Office of the Auditor General
660 J Street, Suite 300, Sacramento, CA 95814
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Independent Auditors' Report

Members of the Joint Legislative Audit Committee
State of California

We have audited the general purpose financial statements of the State of California as of and for the year ended June 30, 1991, and have issued our report thereon dated December 20, 1991. These general purpose financial statements are the responsibility of management of the State of California. Our responsibility is to express an opinion on these general purpose financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the general purpose financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the general purpose financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

Our audit was made for the purpose of forming an opinion on the general purpose financial statements of the State of California taken as a whole. The schedule of federal assistance is presented for purposes of additional analysis and is not a required part of the general purpose financial statements. The information in that schedule has been subjected to the auditing procedures applied in the audit of the general purpose financial statements and, in our opinion, is fairly presented in all material respects in relation to the general purpose financial statements taken as a whole.

This report is intended for the information of the California State Legislature, including the Joint Legislative Audit Committee, and the management of the executive branch. This restriction is not intended to limit the distribution of this report, which, upon acceptance by the Joint Legislative Audit Committee, is a matter of public record.

OFFICE OF THE AUDITOR GENERAL



CURT DAVIS, CPA
Deputy Auditor General

May 8, 1992

Schedule of Federal Assistance for the Fiscal Year Ended June 30, 1991

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>
Department of Agriculture:		
Forestry Incentives Program	10.064	\$ 13,000
Farm Labor Housing Loans and Grants	10.405	5,568,490
Food Distribution	10.550	89,790,962 A *
Food Stamps	10.551	1,253,797,423 A *
School Breakfast Program	10.553	92,632,137 A O
National School Lunch Program	10.555	416,774,404 A O
Special Milk Program for Children	10.556	941,886
Special Supplemental Food Program for Women, Infants, and Children	10.557	188,757,425 A
Child and Adult Care Food Program	10.558	101,182,584 A *
Summer Food Service Program for Children	10.559	93,081 **

Footnotes are presented on page 310

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>
State Administrative Expenses for Child Nutrition	10.560	8,629,667
State Administrative Matching Grants for Food Stamp Program	10.561	169,140,621 A
Nutrition Education and Training Program	10.564	377,667
Temporary Emergency Food Assistance (Administrative Costs)	10.568	5,888,184
Cooperative Forestry Assistance	10.664	941,993
Other—U.S. Department of Agriculture	10.999	7,841,936
 Department of Commerce:		
Trade Development	11.110	63,022
Economic Development—Support for Planning Organizations	11.302	182,787
Special Economic Development and Adjustment Assistance Program—Sudden and Severe Economic Dislocation and Long-Term Economic Deterioration	11.307	137,523
Anadromous and Great Lakes Fisheries Conservation	11.405	252,683
Interjurisdictional Fisheries Act of 1986	11.407	143,431

Footnotes are presented on page 310

Schedule of Federal Assistance for the
Fiscal Year Ended June 30, 1991

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>
Coastal Zone Management Program Administration Grants	11.419	2,472,962
Coastal Zone Management Estuarine Research Reserves	11.420	65,349
Other—U.S. Department of Commerce	11.999	163,151
Department of Defense:		
Flood Control Projects	12.106	121,156
Navigation Projects	12.107	101,998
Planning Assistance to States	12.110	244,000
Payments to States in Lieu of Real Estate Taxes	12.112	607,666
State Memorandum of Agreement Program for the Reimbursement of Technical Services	12.113	357,343
Other—U.S. Department of Defense	12.999	2,540,760
Department of Housing and Urban Development:		
Lower Income Housing Assistance Program—Section 8 Moderate Rehabilitation	14.156	579,624
Rental Voucher Program	14.177	1,173,326

Footnotes are presented on page 310

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>
Rental Certificate Program	14.180	18,598,851
Supportive Housing Demonstration Program	14.235	329,718
Community Development Block Grants/Small Cities Program	14.219	231,446
Community Development Block Grants/State's Program	14.228	15,670,194
Rental Housing Rehabilitation	14.230	427,005
Emergency Shelter Grants Program	14.231	1,262,587
Equal Opportunity in Housing	14.400	369,760
 Department of Interior:		
Small Reclamation Projects	15.503	832,863 O
Anadromous Fish Conservation	15.600	43,096
Fishery Research—Information	15.604	555,456
Sport Fish Restoration	15.605	7,081,912
Wildlife Restoration	15.611	5,899,582
Endangered Species Conservation	15.612	470,489
Historic Preservation Fund Grants-In-Aid	15.904	574,939

Footnotes are presented on page 310

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>
Outdoor Recreation—Acquisition, Development and Planning	15.916	1,398,292
Shared Revenues—Potash/Sodium Lease	15.999	28,166,880 A
Other—U.S. Department of the Interior	15.999	3,001,021
Department of Justice:		
Juvenile Justice and Delinquency Prevention—Allocation to States	16.540	6,953,583
Criminal Justice Statistics Development	16.550	36,053
Justice Research and Development Project Grants	16.560	877,568
Criminal Justice Discretionary Grant Program	16.574	2,289,974
Crime Victim Assistance	16.575	4,512,631
Crime Victim Compensation	16.576	13,370,000
Emergency Federal Law Enforcement Assistance	16.577	680,462
Drug Control and System Improvement—Formula Grant	16.579	27,013,034 A

Footnotes are presented on page 310

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>
Corrections—Technical Assistance/ Clearinghouse	16.603	93,510
Drug Law Enforcement Program— Prison Capacity	16.581	88,021
Other—Department of Justice	16.999	782,879
Department of Labor:		
Labor Force Statistics	17.002	4,769,616
Employment Service	17.207	82,769,834 A O
Unemployment Insurance	17.225	274,416,637 A O
Senior Community Service Employment Program	17.235	5,810,183
Employment and Training Assistance—Dislocated Workers	17.246	35,358,227 A
Employment Services and Job Training—Pilot and Demonstration Programs	17.249	964
Job Training Partnership Act	17.250	261,828,721 A O
Occupational Safety and Health	17.500	17,908,773
Mine Health and Safety Grants	17.600	163,813
Disabled Veterans Outreach Program	17.801	8,922,013

Footnotes are presented on page 310

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>
Veterans Employment Program	17.802	1,028,611
Local Veterans Employment Representative Program	17.804	6,020,722
Department of Transportation:		
Boating Safety Financial Assistance	20.005	1,838,809
Airport Improvement Program	20.106	130,952
Highway Planning and Construction	20.205	1,488,163,850 A
Motor Carrier Safety	20.217	2,459,665
Urban Mass Transportation Capital Improvement Grants	20.500	19,510,927 O
Urban Mass Transportation Technical Studies Grants	20.505	661,090 O
Urban Mass Transportation Capital and Operating Assistance Formula Grants	20.507	3,438,521 O
Public Transportation for Nonurbanized Areas	20.509	2,547,169
State and Community Highway Safety	20.600	13,213,560
Pipeline Safety	20.700	255,004
State Marine Schools	20.806	100,000

Footnotes are presented on page 310

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>
Other—U.S. Department of Transportation	20.999	226,202
Department of Treasury:		
Other—U.S. Department of Treasury	21.999	22,906
Equal Employment Opportunity Commission:		
Employment Discrimination—State and Local Anti-Discrimination Agency Contracts	30.002	2,011,420
National Aeronautics and Space Administration:		
Aerospace Education Services Project	43.001	34,439
National Foundation on the Arts and the Humanities:		
Promotion of the Arts—Dance	45.002	60,000
Promotion of the Arts—Arts in Education	45.003	227,345
Promotion of the Arts—State Program	45.007	623,651

Footnotes are presented on page 310

Schedule of Federal Assistance for the
Fiscal Year Ended June 30, 1991

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>
Promotion of the Arts—Challenge Grants	45.013	61,572
Promotion of the Arts—Folk Arts	45.015	41,089
Promotion of the Humanities—Office of Preservation	45.149	11,000
 National Science Foundation:		
Engineering Grants	47.041	12,116
Mathematical and Physical Sciences	47.049	160,185
Geosciences	47.050	81,224
Biological, Behavioral, and Social Sciences	47.051	38,173
Materials Development, Research, and Informal Science Education	47.067	58,235
Science and Technology Centers	47.073	9,694
 Small Business Administration:		
Small Business Development Center	59.037	15,007
 Department of Veterans Affairs:		
Grants to States for Construction of State Home Facilities	64.005	458,072

Footnotes are presented on page 310

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>
Veterans State Domiciliary Care	64.014	2,220,255
Veterans State Nursing Home Care	64.015	4,072,960
Veterans State Hospital Care	64.016	100,746
Veterans Educational Assistance	64.111	144,545
Other—U.S. Department of Veterans Affairs	64.999	840,416

Environmental Protection Agency:

Air Pollution Control—Technical Training	66.006	69,900
Air Pollution Control—National Ambient Air and Source Emission Data	66.007	156,352
State Indoor Radon Grants	66.032	31,800
Construction Grants for Wastewater Treatment Works	66.418	1,035,915
Water Pollution Control—State and Interstate Program Support	66.419	4,404,423
Water Pollution Control—Lake Restoration Cooperative Agreements	66.435	94,436
Construction Management Assistance	66.438	3,413,006

Footnotes are presented on page 310

Schedule of Federal Assistance for the
Fiscal Year Ended June 30, 1991

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>
Water Quality Management Planning	66.454	1,640,722
National Estuary Program	66.456	396,253
Capitalization Grants for State Revolving Funds	66.458	71,673,503 A
Nonpoint Source Reservation	66.459	814,908
Nonpoint Source Implementation	66.460	1,199,964
Safe Drinking Water Research and Demonstration	66.506	3,087,441
Toxic Substances Research	66.507	24,129
Toxic Substances Compliance Monitoring Program	66.701	36,625
Hazardous Waste Management State Program Support	66.801	5,098,615
Hazardous Substance Response Trust Fund	66.802	6,092,563
State Underground Storage Tanks Program	66.804	448,349
Underground Storage Tank Trust Fund Program	66.805	4,298,291
Pollution Prevention Incentives for States	66.900	73,820

Footnotes are presented on page 310

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>
Other—U.S. Environmental Protection Agency	66.999	591,941
Action:		
Foster Grandparent Program	72.001	1,086,978
Senior Companion Program	72.008	7,665
Department of Energy:		
State Energy Conservation	81.041	693,577
Weatherization Assistance for Low-Income Persons	81.042	2,761,698
Energy Extension Service	81.050	270,658
Energy Conservation for Institutional Buildings	81.052	101,866
Environmental Restoration	81.092	1,018,922
Federal Emergency Management Agency:		
Flood Insurance	83.100	119,276
Emergency Management Institute—Field Training Program	83.403	298,432
Civil Defense—State and Local Emergency Management Assistance	83.503	5,633,193

Footnotes are presented on page 310

Schedule of Federal Assistance for the
Fiscal Year Ended June 30, 1991

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>
Other State and Local Direction, Control and Warning	83.504	5,800
State Disaster Preparedness Grants	83.505	11,031
Facility Survey, Engineering and Development	83.509	108,580
State and Local Warning and Communication Systems	83.513	43,606
Population Protection Planning	83.514	583,559
Disaster Assistance	83.516	89,322,439 A
Hazard Mitigation Assistance	83.519	9
Earthquake Hazards Reduction Grants	83.521	1,077,095
Radiological Defense	83.522	583,647

Department of Education:

Adult Education— State-Administered Basic Grant Program	84.002	10,462,882
Bilingual Education	84.003	1,042,220
Desegregation Assistance, Civil Rights Training, and Advisory Services	84.004	540,407

Footnotes are presented on page 310

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>
Supplemental Educational Opportunity Grants	84.007	7,896,932
Education of Handicapped Children in State Operated or Supported Schools	84.009	1,825,426
Chapter 1 Programs—Local Educational Agencies	84.010	462,809,832 A
Migrant Education—Basic State Formula Grant Program	84.011	96,607,263 A
Educationally Deprived Children—State Administration	84.012	4,957,142
Chapter 1 Program for Neglected and Delinquent Children	84.013	3,049,475
Disabled—Innovation and Development	84.023	80,809
Services for Deaf-Blind Children and Youth	84.025	833,412
Special Education—State Grants	84.027	153,751,446 A
Special Education—Special Education Personnel Development	84.029	422,570
Guaranteed Student Loans	84.032	333,732,542 A
College Work-Study Program	84.033	9,868,906
Public Library Services	84.034	7,272,507

Footnotes are presented on page 310

Schedule of Federal Assistance for the
Fiscal Year Ended June 30, 1991

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>
Interlibrary Cooperation	84.035	1,848,190
National Defense/National Direct/ Perkins Loans Cancellations	84.037	477,705
Perkins Loan Program—Federal Capital Contributions	84.038	1,020,028
Vocational Education—Basic Grants to States	84.048	78,409,992 A
Vocational Education—Consumer and Homemaking Education	84.049	3,037,368
Vocational Education— State Councils	84.053	406,161
Higher Education—Cooperative Education	84.055	17,489
Pell Grant Program	84.063	85,426,122 B
Higher Education—Veterans Education Outreach Program	84.064	10,713
Grants to States for State Student Incentives	84.069	9,086,982
Special Education—Severely Handicapped Program	84.086	386,704
Fund for the Improvement of Postsecondary Education	84.116	95,886
Rehabilitation Services— Basic Support	84.126	139,797,441 A O

Footnotes are presented on page 310

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>
Rehabilitation Services—Service Projects	84.128	952,247
Rehabilitation Training	84.129	145,938
Centers for Independent Living	84.132	360,823
National Institute on Disability and Rehabilitation Research	84.133	13,587
Migrant Education—Coordination Program	84.144	47,594
Transition Program for Refugee Children	84.146	27,901
Federal, State, and Local Partnerships for Educational Improvement	84.151	49,684,156 A
Public Library Construction and Technology Enhancement	84.154	1,797,579
Removal of Architectural Barriers to the Handicapped	84.155	311,703
Emergency Immigrant Education	84.162	13,548,735
Eisenhower Mathematics and Science Education—State Grants	84.164	17,009,954
National Program for Mathematics and Science Education	84.168	548,630
Comprehensive Services for Independent Living	84.169	1,039,932

Footnotes are presented on page 310

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>
Jacob K. Javits Fellowships	84.170	32,000
Special Education—Preschool Grants	84.173	31,980,933 A
Vocational Education—Community Based Organizations	84.174	504,589
Paul Douglas Teacher Scholarships	84.176	1,816,841
Infants and Toddlers With Disabilities	84.181	10,220,000
Robert C. Byrd Honors Scholarships	84.185	910,900
Drug-Free Schools and Communities—State Grants	84.186	49,479,121 A
Supported Employment Services for Individuals with Severe Handicaps	84.187	1,857,347
Adult Education for the Homeless	84.192	487,284
State Activities—Education for Homeless Children and Youth	84.196	549,307
Jacob K. Javits Gifted and Talented Students	84.206	243,338
Capital Expenses	84.216	2,867,813
State Program Improvement Grants	84.218	1,557,918
English Literacy Program	84.223	500,557
Mid-Career Teacher Training	84.232	1,476

Footnotes are presented on page 310

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>
Compensatory Education Grant Back Awards	84.995	340,610
Other—Department of Education	84.999	42,000
Consumer Product Safety Commission:		
Other—Consumer Product Safety Commission	87.999	10,448
National Archives and Records Administration:		
National Historical Publications and Records Grants	89.003	51,348
Department of Health and Human Services:		
State Comprehensive Mental Health Service Planning Development Grants	13.158	32,373
Family Support Payments to States—Assistance Payments	93.020	2,911,291,676 A
Job Opportunities and Basic Skills Training	93.021	109,483,161 A O
Child Support Enforcement	93.023	141,593,521 A
State Legalization Impact Assistance Grants	93.025	650,895,599 A O

Footnotes are presented on page 310

Schedule of Federal Assistance for the
Fiscal Year Ended June 30, 1991

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>
Refugee and Entrant Assistance— State Administered Programs	93.026	76,711,552 A
Low-Income Home Energy Assistance	93.028	68,096,779 A
Community Services Block Grant	93.031	32,120,888 A
Community Services Block Grant Discretionary Awards—Community Food and Nutrition	93.033	99,237
Emergency Community Services for the Homeless	93.034	1,277,266
Food and Drug Administration— Research	93.103	252,963
Project Grants and Cooperative Agreements for Tuberculosis Control Programs	93.116	360,500
Acquired Immunodeficiency Syndrome (AIDS) Activity	93.118	10,865,881
Mental Health Planning and Demonstration Projects	93.125	400,305
Injury Prevention and Control Research Projects	93.136	366,635
Alcohol, Drug Abuse Treatment and Rehabilitation Block Grant	93.141 *** (13.141)	54,511

Footnotes are presented on page 310

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>
Drug and Alcohol Abuse Prevention—High-Risk Youth Demonstration Grants	93.144	519,946
Temporary AIDS Drug Reimbursements	93.146	9,900,047
Mental Health Services for the Homeless Block Grant	93.150	2,821,300
Health Program for Toxic Substances and Disease Registry	93.161	172,250
Community Youth Activity Demonstration Grants	93.170	118,519
Community Youth Activity Program Block Grants	93.171	71,624
Drug Abuse Treatment Waiting List Reduction Grants	93.175	9,623,842
State Data Collection—Uniform Alcohol and Drug Abuse Data	93.179	206,066
Scholarships for the Undergraduate Education of Professional Nurses	93.182	14,924
Disaster Relief Assistance Grants for Drug Abuse Treatment	93.195	489,904
Cooperative Agreements for Drug Abuse Treatment Improvement Projects in Target Cities	93.196	53,814
Home and Community-Based Health Services	93.199	135,000

Footnotes are presented on page 310

Schedule of Federal Assistance for the
Fiscal Year Ended June 30, 1991

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>
Mental Health Research Grants	93.242	700,448
Mental Health Clinical or Service Related Training Grants	93.244	41,272
Childhood Immunization Grants	93.268	1,234,600
Centers for Disease Control— Investigations and Technical Assistance	93.283	750,885
Biomedical Research Support	93.337	2,822
Professional Nurse Traineeships	93.358	136,419
Cancer Control	93.399	19,356
Special Programs for the Aging Title III, Part G—Prevention of Abuse, Neglect, and Exploitation of Older Individuals	93.552	55,343
Special Programs for the Aging Title III, Part A—Long-Term Care Ombudsman Services for Older Individuals	93.553	102,300
Administration on Developmental Disabilities—Basic Support and Advocacy Grants	93.630	4,667,151
Special Programs for the Aging— Title III, Part B—Grants for Supportive Services and Senior Centers	93.633	27,941,785 A

Footnotes are presented on page 310

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>
Special Programs for the Aging— Title III, Part C—Nutrition Services	93.635	38,684,555 A
Special Programs for the Aging— Title III, Part D—In-Home Services for Frail Older Individuals	93.641	658,257
Child Welfare Services—State Grants	93.645	27,106,293 A
Temporary Child Care and Crisis Nurseries	93.656	364,871
Foster Care—Title IV-E	93.658	463,645,774 A O
Adoption Assistance	93.659	21,522,558 A
Social Services Block Grant	93.667	323,363,033 A
Special Programs for the Aging— Title IV—Training, Research and Discretionary Projects and Programs	93.668	145,153
Administration for Children, Youth and Families—Child Abuse and Neglect State Grants	93.669	199,444
Administration for Children, Youth and Families—Child Abuse and Neglect Discretionary Activities	93.670	91,446
Family Violence Prevention and Services	93.671	767,305

Footnotes are presented on page 310

Schedule of Federal Assistance for the
Fiscal Year Ended June 30, 1991

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>
Child Abuse Challenge Grants	93.672	578,266
Grants to States for Planning and Development of Dependent Care Programs	93.673	1,234,753
Independent Living	93.674	5,695,900
Medicare—Hospital Insurance	93.773	2,394,512
Medicare—Supplementary Medical Insurance	93.774	11,454,848
State Medicaid Fraud Control Units	93.775	6,623,500
State Survey and Certification of Health Care Providers and Suppliers	93.777	10,249,104
Medical Assistance Program	93.778	4,411,659,632 A O
Social Security—Disability Insurance	93.802	99,861,307 A
Microbiology and Infectious Diseases Research	93.856	49,164
Cellular and Molecular Basis of Disease Research	93.863	141,250
Model Comprehensive Treatment Programs for Critical Populations	93.902	2,989,129

Footnotes are presented on page 310

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>
Model Criminal Justice Drug Abuse Treatment—Incarcerated Populations—Nonincarcerated Populations	93.903	237,095
Preventive Health Services—Sexually Transmitted Diseases Control Grants	93.977	1,754,370
Mental Health Disaster Assistance and Emergency Mental Health	93.982	2,617,346
Health Programs for Refugees	93.987	816,600
Cooperative Agreements for State-Based Diabetes Control Programs and Evaluation of Surveillance Systems	93.988	118,500
Preventive Health and Health Services Block Grant	93.991	5,951,879
Alcohol and Drug Abuse and Mental Health Services Block Grant	93.992	159,461,336 A
Maternal and Child Health Services Block Grant	93.994	31,233,279 A
Other—Department of Health and Human Services	93.999	5,733,776
Miscellaneous Grants and Contracts:		
Shared Revenue—Flood Control Lands	98.002	284,873
Shared Revenue—Forest Resources	98.003	64,160,870 A

Footnotes are presented on page 310

Schedule of Federal Assistance for the
Fiscal Year Ended June 30, 1991

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>
Shared Revenue—Grazing Land	98.004	257,977
Federal Unemployment Benefits and Allowances	98.010	527,983
U.S. Department of Housing and Urban Development—College Housing Debt Service Government Program	98.013	633,537
U.S. Department of the Interior—Fire Prevention/Suppression Agreement	98.014	10,073
U.S. Department of the Interior—Fire Prevention/Suppression Agreement	98.015	90,167
U.S. Department of Agriculture and Various Other U.S. Departments—Fire Prevention/Suppression Agreements	98.016	11,775,817

Footnotes are presented on page 310

<u>Federal Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Amounts Received</u>
Miscellaneous Federal Receipts	98.099	201,496
Miscellaneous Federal Receipts	98.999	4,121,137
Miscellaneous Uncleared Collections	99.999	<u>6,171,524</u>
Total Grants Received		<u>\$16,337,889,261</u>
Total Major Grants Audited in Compliance With OMB, Circular A-128		<u>\$15,725,875,005</u>

Note: In addition, the State received \$19,060,648 in Petroleum Violation Escrow Funds that can be used to supplement five federal energy-related conservation and assistance programs. The funds used to supplement these programs were audited to the extent required by the OMB's, Circular A-128.

A - The Office of the Auditor General reviewed these major grants for fiscal year 1990-91 in compliance with the OMB's, Circular A-128.

O - The Office of the Auditor General reviewed these grants in conjunction with various reports issued from July 1, 1990, to December 31, 1991. See the Schedule of Audit Reports Involving Federal Grants From July 1, 1990, to December 31, 1991, beginning on page 317 for a description of these reports.

B - Other independent auditors audited this grant. The grant amount is not included in the amount of total major grants audited on this page.

* - This amount includes cash, food stamps, and the value of commodities.

** - This amount represents the value of commodities only.

*** - The federal government changed the federal catalog number for fiscal year 1990-91. The number in parentheses represents the former federal catalog number.

**Weaknesses in Compliance With Federal Regulations
by Grant Program**

Federal Catalog Number	Grantor Agency/Program Title	Administering State Agency	Page Number	Number of Occurrences ^a			
				Inadequate/ Late Reports	Insufficient Support for Expenditures	Insufficient Monitoring/ Auditing	Early Request/Late Disbursement of Federal Funds
Department of Agriculture							
10.550	Food Distribution	California Department of Education	121		1		
10.553	School Breakfast Program	California Department of Education Department of the Youth Authority	121 273		1		
10.555	National School Lunch Program	California Department of Education Department of the Youth Authority	121 273		1		
10.557	Special Supplemental Food Program for Women, Infants, and Children	Department of Health Services	173	1		3	2
10.558	Child and Adult Care Food Program	California Department of Education	121		1		
10.561	State Administrative Matching Grants for Food Stamp Program	Department of Social Services	200	1	1		1
Department of Justice							
16.579	Drug Control and System Improvement-Formula Grant	Office of Criminal Justice Planning	135		1		

^aThis is the number of occurrences of each weakness as presented in the state agencies' management letters.

Federal Catalog Number	Grantor Agency/Program Title	Administering State Agency	Page Number	Number of Occurrences^a			
				Inadequate/ Late Reports	Insufficient Support for Expenditures	Insufficient Monitoring/ Auditing	Early Request/Late Disbursement of Federal Funds
Department of Labor							
17.207	Employment Service	Employment Development Department	164	1			
17.225	Unemployment Insurance	Employment Development Department	164	2			
17.250	Job Training Partnership Act	Employment Development Department	164			2	
Department of Transportation							
20.205	Highway Planning and Construction	Department of Transportation	80	2	1		2
Environmental Protection Agency							
66.458	Capitalization Grants for State Revolving Funds	State Water Resources Control Board	233			1	
Federal Emergency Management Agency							
83.516	Disaster Assistance	Office of Emergency Services	211			2	
Department of Education							
84.010	Chapter 1 Programs--Local Educational Agencies	California Department of Education	121		1		1
84.011	Migrant Education--Basic State Formula Grant Program	California Department of Education	121			1	
84.027	Special Education--State Grants	California Department of Education	121				1

^aThis is the number of occurrences of each weakness as presented in the state agencies' management letters.

Federal Catalog Number	Grantor Agency/Program Title	Administering State Agency	Page Number	Number of Occurrences ^a			
				Inadequate/ Late Reports	Insufficient Support for Expenditures	Insufficient Monitoring/ Auditing	Early Request/Late Disbursement of Federal Funds
84.032	Guaranteed Student Loans	California Student Aid Commission	110	2			8
84.048	Vocational Education--Basic Grants to States	California Community Colleges, Chancellor's Office California Department of Education	91 121	1 1			1
84.151	Federal, State, and Local Partnerships for Educational Improvement	California Department of Education	121				1
84.173	Special Education--Preschool Grants	California Department of Education	121		1		1
84.186	Drug-Free Schools and Communities--State Grants	California Department of Education Department of Alcohol and Drug Programs Office of Criminal Justice Planning	121 157 135		3 -2 2	1 2 1	1
Department of Health and Human Services							
93.020	Family Support Payments to States--Assistance Payments	Department of Social Services	200	2		1	1
93.021	Job Opportunities and Basic Skills Training	Department of Social Services	200	2			

^aThis is the number of occurrences of each weakness as presented in the state agencies' management letters.

Federal Catalog Number	Grantor Agency/Program Title	Administering State Agency	Page Number	Number of Occurrences ^a			
				Inadequate/ Late Reports	Insufficient Support for Expenditures	Insufficient Monitoring/ Auditing	Early Request/Late Disbursement of Federal Funds
93.023	Child Support Enforcement	Department of Social Services	200	1			
93.025	State Legalization Impact Assistance Grants	Department of Mental Health Office of the Secretary of the Health and Welfare Agency Department of Social Services California Department of Education Department of Health Services Department of Fair Employment and Housing	192 221 200 1 121 173 243	1 1 1 1 1 1 1		1 1 1 1	1 1 1 1
93.026	Refugee and Entrant Assistance--State Administered Programs	Department of Social Services Department of Health Services	200 173	1		1	1
93.028	Low-Income Home Energy Assistance	Department of Economic Opportunity	141			1	
93.031	Community Services Block Grant	Department of Economic Opportunity	141			1	
93.645	Child Welfare Services--State Grants	Department of Social Services	200	2			
93.658	Foster Care--Title IV-E	Department of Social Services	200	3			
93.659	Adoption Assistance	Department of Social Services	200	3			
93.778	Medical Assistance Program	Department of Health Services	173				2
93.802	Social Security--Disability Insurance	Department of Social Services	200	2			

^aThis is the number of occurrences of each weakness as presented in the state agencies' management letters.

Federal Catalog Number	Grantor Agency/Program Title	Administering State Agency	Page Number	Number of Occurrences ^a			
				Inadequate/ Late Reports	Insufficient Support for Expenditures	Insufficient Monitoring/ Auditing	Early Request/Late Disbursement of Federal Funds
93.992	Alcohol and Drug Abuse and Mental Health Services Block Grant	Department of Alcohol and Drug Programs Department of Mental Health	157 192			2 2	4 1
93.994	Maternal and Child Health Services Block Grant	Department of Health Services	173		1		1
Various Federal Departments							
Numerous Federal Programs	Stephen P. Teale Data Center		66				1
Numerous Federal Programs	Department of General Services		250				1
Numerous Federal Programs	Health and Welfare Agency Data Center		171				1
Numerous Federal Programs	Department of Finance		144				3
Numerous Federal Programs	Public Employees' Retirement System		266				1
Numerous Federal Programs	California Department of Education		121		1		1

^aThis is the number of occurrences of each weakness as presented in the state agencies' management letters.

**Schedule of Audit Reports
Involving Federal Grants From
July 1, 1990, to December 31, 1991**

From July 1, 1990, to December 31, 1991, the Office of the Auditor General issued reports on audits involving federal grants. The following schedule lists the reports issued and presents a summary of the report findings. The agencies' responses to these findings are included in each of the separate audit reports.

<u>Agency Receiving Federal Funds</u>	<u>Federal Grant and Federal Catalog Number</u>	<u>Report Title and Description</u>
Alameda-Contra Costa Transit District	Urban Mass Transportation Capital Improvement Grants, Urban Mass Transportation Technical Studies Grant, and Urban Mass Transportation Capital and Operating Assistance Formula Grants 20.500 20.505 20.507	<p>Alameda-Contra Costa Transit District: Seventh Quarterly Monitoring Report (P-861.7, 7-5-90)</p> <p>(1) Since the release of our March 1988 report about the Alameda-Contra Costa Transit District's (district) financial and administrative controls, our quarterly reports have shown that the district has improved its budgeting process. However, the district's revised budget for fiscal year 1989-90 has a projected \$2.0 million deficit primarily because of expenses the district incurred as a result of the October 1989 earthquake.</p> <p>(2) The district's operating budget for fiscal year 1990-91 projects that district revenues and subsidies will equal expenses, resulting in a balanced budget. The district's budget for fiscal year 1990-91 contains provisions for a fare increase to enhance district revenues and also contains funding for the implementation of the district's comprehensive service plan, which is intended to increase the number of passengers using district buses. However, the district plans to reduce some bus services to decrease its operating expenses.</p> <p>(3) The district has revised its rules and added new policies that appear to better control the travel and personal expenses of its directors and district officers.</p>

Agency Receiving Federal FundsFederal Grant and Federal Catalog NumberReport Title and Description

Alcohol and Drug Programs, Department of	Medical Assistance Program 93.778	A Review of the Department of Alcohol and Drug Programs' Drug/Medi-Cal Claims Process (P-965, 7-17-91)	(4) The district has added and disseminated new policies that prohibit employees from using district resources for nondistrict purposes.
Developmental Services, Department of	Various Federal Grants	A Review of the Seven Developmental Centers Operated by the Department of Developmental Services (P-961, 5-8-91)	(1) A small number of providers of methadone maintenance services submitted and were paid for duplicate claims in fiscal year 1989-90. (2) One county submitted and was paid for claims representing incompatible drug treatment services in at least 32 instances in fiscal year 1989-90. (3) In several instances, providers did not submit to the department disallowances of claims for drug treatment services.
			(1) Developmental center staff did not always follow the appropriate procedures when using physical and chemical restraints on clients. (2) Developmental centers are generally meeting the federal and state staffing standards we tested for direct care staff; however, they are not meeting the staffing guidelines established by the department. (3) Direct care staff at the developmental centers are sometimes diverted to perform duties that are not directly related to client care.

<u>Agency Receiving Federal Funds</u>	<u>Federal Grant and Federal Catalog Number</u>	<u>Report Title and Description</u>
Education, California Department of Employment Development Department Fair Employment and Housing, Department of Health Services, Department of Housing and Community Development, Department of Mental Health, Department of Social Services, Department of	State Legalization Impact Assistance Grants 93.025	<p>(4) Staff at the developmental centers are not always documenting the implementation of client's Individual Program Plans.</p> <p>(5) Staff at the developmental centers are not always documenting client's progress toward accomplishing objectives established in clients' Individualized Education Programs.</p> <p>(6) Staff at the developmental centers are following proper procedures when reporting special incidents to management within the developmental center.</p> <p>Status of Costs Identified and Reimbursed for the State Legalization Impact Assistance Grants (F-132, 10-23-91)</p> <p>(1) As of June 30, 1991, the State had identified and paid almost \$1.15 billion in costs for the State Legalization Impact Assistance Grants (SLIAG) program and received reimbursements from the federal government for approximately the same amount. As of the same date, almost \$310 million remained from the federal grant allocations through federal fiscal year 1991.</p> <p>(2) The State is currently identifying and claiming additional costs incurred as of June 30, 1991, that were unclaimed at that date. We estimate that, by the end of the federal fiscal year 1991, the State will have exhausted the \$310 million that remained in the federal allocation as of June 30, 1991.</p> <p>(3) The State has improved its ability to identify and claim costs under the SLIAG program.</p>

Agency Receiving Federal Funds

<u>Federal Grant and Federal Catalog Number</u>	<u>Report Title and Description</u>
Employment Development Department	<p>Federal and State Equity in EDD Owned Buildings (F-051, 4-4-91)</p> <p>(1) Our review of the Employment Development Department's (EDD) records showed that, for most of EDD's properties in which the United States Department of Labor (DOL) has an equity interest, the DOL and the EDD initially agreed that federal grant funds would be used to repay the initial financing of the property and that the payments would result in a federal equity interest in the property.</p> <p>(2) The EDD's records indicate that the total historical cost of the properties in which the DOL has an equity interest is at least \$51 million. The DOL's equity interest in these properties as of January 31, 1991, is at least \$24 million based on the historical cost of the properties.</p>
Employment Service	<p>The Department of Health Services' Information on Drug Treatment Authorization Requests: First and Second Monitoring Reports (P-044, 1-31-91 and P-117, 7-24-91)</p> <p>(1) From June 1990 through May 1991, the total number of all drug treatment authorization requests (TARs) received by mail, telephone, telephone facsimile machine, and the Department of Health Services' (department) new automated voice response system varied from a low of 11,521 drug TARs during September 1990 to a high of 15,415 drug TARs received during April 1991.</p> <p>(2) The department's backlog of drug TARs received by mail that were not processed during a month varied from a high of 3,295 at the end of July 1990 to a low of 1,202 at the end of January 1991.</p>
Health Services, Department of	<p>Medical Assistance Program</p> <p>93.778</p>

<u>Agency Receiving Federal Funds</u>	<u>Federal Grant and Federal Catalog Number</u>	<u>Report Title and Description</u>
Health Services, Department of	Medical Assistance Program 93.778	A Review of the Department of Health Services' Estimates of Savings Resulting from the Medi-Cal Drug Discount Program (P-113, 6-19-91) <ul style="list-style-type: none"> (1) The Department of Health Services will not realize a \$50 million savings through a drug discount program as it had estimated initially in the Governor's Budget for fiscal year 1990-91.
Health Services, Department of	Medical Assistance Program 93.778	How Medi-Cal and Other Health Care Providers Manage Their Pharmaceutical Expenditures (P-062, 8-30-91) <ul style="list-style-type: none"> (1) California Medical Assistance Program (Medi-Cal) drug expenditures grew from \$231 million in 1984 to an estimated \$516 million in 1989, or by 124 percent. This growth in expenditures is due to both an expanded use of the Medi-Cal drug benefit and also an increase in the average cost per prescription. (2) In an attempt to stem increases in Medi-Cal expenditures, Medi-Cal uses most of the same utilization and price strategies as those identified by the major pharmaceutical purchasers we surveyed. (3) For a sample of six prescription drugs, we surveyed six pharmacists on what amounts they would bill Medi-Cal and we determined what amounts they would be reimbursed. We found that for the same prescription drug, a significant difference exists in the amounts pharmacies would have billed Medi-Cal and the amounts Medi-Cal would have reimbursed the six pharmacies. (4) The variation in amounts or reimbursements among the six pharmacies revealed that a significant difference exists in what Medi-Cal would have reimbursed the six pharmacies for the same drug.

<u>Agency Receiving Federal Funds</u>	<u>Federal Grant and Federal Catalog Number</u>	<u>Report Title and Description</u>
Lake Elsinore Municipal Water District	Small Reclamation Projects 15.503	<p>The Lake Elsinore Management Project (P-042, 8-1-91)</p> <p>(1) Since the United States Bureau of Reclamation approved funding for the Lake Elsinore Management Project in 1985, the design of the project has changed in part because the City of Lake Elsinore requested modifications to accommodate its redevelopment plan for the lake.</p> <p>(2) Our review of the project's documents indicates that expenditures for the project totaled \$25 million through June 1990.</p>
Los Angeles County Department of Children's Services, Department of Social Services	Foster Care—Title IV-E 93.658	<p>Los Angeles County Needs To Improve Its Services to Foster Children and the State Needs To Improve Its Oversight of the County's Foster Care Program (P-927, 12-12-90)</p> <p>(1) The Los Angeles County Department of Children's Services is not complying with visitation and medical history requirements, and it may be placing more foster children in foster homes than the law allows.</p> <p>(2) The Department of Social Services (department) did not conduct compliance audits of the county's foster care program every three years as required and did not ensure that the county corrected deficiencies found during the last compliance audit.</p> <p>(3) The department takes an average of 12 months to process requests for license revocations against foster parents who may be neglecting or abusing children in the county.</p> <p>(4) The department failed to take the necessary steps to claim an estimated \$156 million in federal funds from March 1987 to June 1, 1990, for administering the State's foster care program in all 58 counties.</p>

<u>Agency Receiving Federal Funds</u>	<u>Federal Grant and Federal Catalog Number</u>	<u>Report Title and Description</u>
Los Angeles County Department of Public Social Services	Job Training Partnership Act 17.250	A Review of Los Angeles County's Implementation of the Greater Avenues for Independence Program (P-919, 2-6-91) <ul style="list-style-type: none"> (1) The county complied with state guidelines and regulations and with county policy in the design and implementation of its program and can provide the 14 mandated services of the 17 services allowed by law. (2) The county could not utilize \$14.4 million of the \$45.4 million in state and federal funds allotted to it for program services by the Department of Social Services for fiscal year 1989-90 because of a state budget restriction and county policy that limited the expenditure of those funds. As a result, the county could refer only 10,500 (53 percent) people out of the approximately 20,000 people whom it estimated it could have served during fiscal year 1989-90. (3) The county's contractor of case management services is generally providing services in accordance with contract requirements.
Rehabilitation, Department of	Rehabilitation Services—Basic Support 84.126	The Department of Rehabilitation Has Weaknesses in the Control and Management of Equipment Used for the Business Enterprise Program (F-958, 7-5-90) <ul style="list-style-type: none"> (1) Our audit of the Business Enterprise Program for the Blind (program), administered by the Department of Rehabilitation (department), disclosed that the department has weaknesses in its purchase and use of equipment for the program. (2) In some instances, the department's controls over the transfer and disposal of equipment are inadequate.

<u>Agency Receiving Federal Funds</u>	<u>Federal Grant and Federal Catalog Number</u>	<u>Report Title and Description</u>
Sweetwater Union High School District	School Breakfast Program 10.553	To Adequately Manage and Protect Its Assets, the Sweetwater Union High School District Needs To Improve Its Control Over Its Financial Operations (F-962, 7-25-90) <ul style="list-style-type: none"> (1) Because of weak internal controls, the Sweetwater Union High School District (district) has been susceptible to misappropriation of district assets, as well as other abuses, although we found no evidence during our review to support allegations of criminal activities at the district.
National School Lunch Program	National School Lunch Program 10.555	The Martin Luther King Jr. Family Health Center Needs To Improve Its Financial Operations (P-021, 4-17-91) <ul style="list-style-type: none"> (1) As of March 31, 1991, the Martin Luther King Jr. Family Health Center continues to have financial difficulties, and it needs to improve its billing and collecting for the reimbursement of health care services, its controls over its professional services contracts, its purchasing and cash disbursements operations, and its accounting and administrative operations.
West Contra Costa Community Health Care Corporation	Community Health Centers 93.224	Martin Luther King Jr. Family Health Center

**Schedule of Minor Federal Issues for the
Fiscal Year Ended June 30, 1991**

Agency Receiving Federal Funds	Federal Grant and Federal Catalog Number	Description of Issue
California Community Colleges, Chancellor's Office	Vocational Education—Basic Grants to States 84.048	<ul style="list-style-type: none"> (1) The Chancellor's Office submitted its final financial status report for its fiscal year 1988-89 vocational education program on February 28, 1991, 59 days after the due date of December 31, 1990. (2) On one invoice submitted to the California Department of Education for reimbursement of expenditures made for the Vocational Education program, the Chancellor's Office requested \$364 more than the amount to which it was entitled.
California School for the Deaf, Northern California	Chapter 1 Programs—Local Educational Agencies (Chapter 1) 84.010	<ul style="list-style-type: none"> (1) The school reported to the California Department of Education that it had \$43,126 of Chapter 1 funds available for carryover to fiscal year 1989-90 from fiscal year 1988-89 when the school's accounting records indicated it had \$62,771. The audited amount was \$1,609. The discrepancy resulted from the school failing to apply Chapter 1 advance collections to unreimbursed expenditures for fiscal years 1986-87 and 1988-89.
California School for the Deaf, Northern California	Vocational Education—Basic Grants to States 84.048	<ul style="list-style-type: none"> (1) The school overcharged the Vocational Education—Basic Grants to States program approximately \$100 for the services of an employee who was not working on program activities.
California School for the Deaf, Northern California	Federal, State, and Local Partnerships for Educational Improvement 84.151	<ul style="list-style-type: none"> (1) The school recorded \$2,398 as Federal, State, and Local Partnerships for Educational Improvement reimbursement although the underlying expenditure had not been recorded. Funds received before the school incurs a related expenditure should be recorded as an advance collection.

<u>Agency Receiving Federal Funds</u>	<u>Federal Grant and Federal Catalog Number</u>	<u>Description of Issue</u>
California Student Aid Commission	Guaranteed Student Loans 84.032	(1) The commission did not correctly calculate the federal share of collections on defaulted student loans for one of the 24 collections that we reviewed. The commission calculated the federal share to be approximately \$30 less than the amount to which the federal government was entitled.
Economic Opportunity, Department of	Low Income Home Energy Assistance Program 13.789	(1) The department did not discover a mathematical error in a contractor's monthly expenditure report. As a result, the department underpaid the contractor by \$120.
Education, California Department of	Food Distribution 10.550	(1) The department did not conduct reviews for 3 of the 32 processors within the required two-year period. One of the three reviews was one month late, and two reviews were three months late.
Education, California Department of	Migrant Education—Basic State Formula Grant Program 84.011	(1) The department did not ensure that all subrecipients submit responses to fiscal review findings within the required 45 days. Six of 16 subrecipients we reviewed submitted the responses to the department 6 to 128 days late.
Education, California Department of	Adult Education—State-Administered Basic Grant Program (Adult Education) 84.002 Chapter 1 Programs—Local Educational Agencies (Chapter 1) 84.010	(1) The department incorrectly allocated administrative costs totalling \$77 to the Chapter 1 program that it should have allocated to the Adult Education program. The department has already corrected the error.
Emergency Services, Office of	Disaster Assistance 83.516	(1) For fiscal year 1990-91, the office submitted five federal cash transaction reports to the Federal Emergency Management Agency (FEMA) from 5 to 124 days late because it believed that the FEMA no longer required these reports.

<u>Agency Receiving Federal Funds</u>	<u>Federal Grant and Federal Catalog Number</u>	<u>Description of Issue</u>
Employment Development Department	Job Training Partnership Act 17.250	<p>(1) The department did not ensure that 1 of the 52 service delivery areas participating in the program had an independent audit as required.</p>
Rehabilitation, Department of	Rehabilitation Services—Basic Support 84.126	<p>(1) Of the 29 open client case files we reviewed, two files did not contain evidence that the department provided the clients with the Client Information Booklet, which informs clients of, among other things, their individual rights and case confidentiality. In addition, one file did not contain evidence of the department's determination of the availability of comparable services and benefits under other programs. Finally, one file did not contain evidence that the department had reviewed the individualized written rehabilitation program annually.</p> <p>(2) The department has not taken a complete physical inventory of equipment since subrecipients began purchasing the equipment in 1987. Until the department completes a physical inventory, it cannot determine if its records are complete and accurate.</p>

Agency Receiving Federal Funds

<u>Federal Grant and Federal Catalog Number</u>	<u>Description of Issue</u>
Social Services, Department of Disaster Assistance 83.516	(3) The department overstated the federal share of Rehabilitation Services—Basic Support program costs for fiscal years 1988-89, 1989-90, and 1990-91 by \$2,830, \$12,674, and \$19,013, respectively. The department subsequently corrected these overstatements. (1) The department did not deduct an insurance payment of \$100 from the amount awarded to a recipient of an individual family grant.
Social Services, Department of Family Support Payments to States— Assistance Payments 93.020	(1) In the quarterly report of expenditures and estimates for the quarter ending June 30, 1991, the department understated the current quarter federal share of expenditures for maintenance assistance by \$3,693. Also, the department understated the federal share of expenditures for state and local administration by \$18.
Social Services, Department of Job Opportunities and Basic Skills Training 93.021	(1) For the quarter ending December 31, 1990, the department overcharged the federal government by \$116 and undercharged the State by \$116. For the quarter ending March 31, 1991, the department overcharged the federal government by \$305 and undercharged the State by \$305. The differences resulted from improperly rounding expenditures that are funded at a 50 percent rate.
Social Services, Department of Foster Care—Title IV-E 93.658	(1) Because of a mathematical error, the department understated the average number of Foster Care recipients by 120 on its June 30, 1991, report.
Transportation, Department of Highway Planning and Construction 20.205	(1) The department overbilled the federal government by \$4.86 because of a clerical error pertaining to an invoice.

<u>Agency Receiving Federal Funds</u>	<u>Federal Grant and Federal Catalog Number</u>	<u>Description of Issue</u>
State Water Resources Control Board	Capitalization Grants for State Revolving Funds 66.458	(1) On its Financial Status Report for the period ending September 30, 1990, the board underreported federal funds authorized for administrative costs by approximately \$850,500 and overreported federal funds authorized for loans by the same amount.
Youth Authority, Department of the	School Breakfast Program 10.553 National School Lunch Program 10.555	(1) The department made clerical errors that resulted in charging the federal government incorrectly for 21 of the 54,832 meals we tested. However, the department also made clerical errors that resulted in not charging the federal government for 15 meals. As a result of these clerical errors, the department overcharged the federal government by \$11.55.

**Report on Compliance
With State Laws and Regulations**



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Independent Auditors' Report

**Members of the Joint Legislative Audit Committee
State of California**

We have audited the general purpose financial statements of the State of California as of and for the year ended June 30, 1991, and have issued our report thereon dated December 20, 1991. We did not audit the financial statements of the pension trust funds, which reflect total assets constituting 79 percent of the fiduciary funds. We also did not audit the financial statements of certain enterprise funds, which reflect total assets and revenues constituting 92 percent and 94 percent, respectively, of the enterprise funds. In addition, we did not audit the University of California funds. The financial statements of these pension trust funds, certain enterprise funds, and the University of California funds referred to above were audited by other auditors who furnished their reports to us, and our opinion, insofar as it relates to the amounts included for the pension trust funds, certain enterprise funds, and the University of California funds, is based solely upon the reports of other independent auditors.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the general purpose financial statements are free of material misstatement.

The management of state agencies is responsible for compliance with laws, regulations, contracts, and grants applicable to the State of California. As part of obtaining reasonable assurance about whether the general purpose financial statements are free of material misstatement, we performed tests of the State of California's compliance with certain provisions of laws, regulations, contracts, and grants. However, the objective of our audit of the financial statements was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

The results of our tests indicate that, with respect to the items tested, the State of California complied, in all material respects, with the provisions referred to in the preceding paragraph. With respect to items not tested, nothing came to our attention that caused us to believe that the State of California had not complied, in all material respects, with those provisions. However, we noted certain immaterial instances of noncompliance that we have reported to the management of agencies of the State of California. We discuss these on pages 55 through 274 of this report.

This report is intended for the information of the California State Legislature, including the Joint Legislative Audit Committee, and the management of the executive branch. This restriction is not intended to limit the distribution of this report, which, upon acceptance by the Joint Legislative Audit Committee, is a matter of public record.

OFFICE OF THE AUDITOR GENERAL



CURT DAVIS, CPA
Deputy Auditor General

May 8, 1992

Appendix A Schedule of Actual and Potential Losses Identified During Our Review of the State's Financial Activities

	Page Number	Lost Interest and Discounts	Amounts Owed to the State for Extended Periods		Unnecessary Expenditures	Lost Revenue
California Community Colleges, Chancellor's Office	91	\$ 104,000	\$ 16,177			
California School for the Deaf, Northern California	101			8,200		
California Student Aid Commission	110				2,900	
Corrections, Department of	271					
Economic Opportunity, Department of	141			6,330		
Education, California Department of	121				\$ 50,310	\$ 4,600
Equalization, Board of	214				21,955	82,569
Emergency Services, Office of	211	118,000				
Employment Development Department	164				200	
Franchise Tax Board	244				330,600	
General Services, Department of	250	44,343				
Health Services, Department of	27 and 173	429,000	175,060,000	45,600	31,000,000	
Mental Health, Department of	192		32,138	12,400		
Motor Vehicles, Department of	59		13,400,000			
Social Services, Department of	200	144,300				
Transportation, Department of	80	217,000				22,452
Water Resources, Department of	229	2,100				
Total		\$1,058,743	\$188,522,845	\$ 463,965	\$ 31,109,621	

**Appendix B Reports Issued by the
Office of the Auditor General From
July 1, 1990, to December 31, 1991**

Date of Issue	Report Title	Report No.
<u>1990</u>		
Jul 05	The Department of Rehabilitation Has Weaknesses in the Control and Management of Equipment Used for the Business Enterprise Program (Letter Report)	F-958
Jul 05	The Alameda-Contra Costa Transit District: Seventh and Final Quarterly Monitoring Report	P-861.7
Jul 25	To Adequately Manage and Protect Its Assets, the Sweetwater Union High School District Needs To Improve Its Control Over Its Financial Operations	F-962
Aug 15	A Review of the Fish and Game Commission's Annual Pack Trip and the Potential Unauthorized Release of Confidential Information by Either the Commission or the Department of Fish and Game (Letter Report)	P-856
Aug 16	A Study of the State's Office Space Facilities Planning Goals, Policies, and Recommendations	C-972
Aug 29	A Review of the Department of General Services' Statewide Property Inventory (Letter Report)	P-660

<u>Date of Issue</u>	<u>Report Title</u>	<u>Report No.</u>
Nov 14	A Review of the Contracting Operations of the Los Angeles County Department of Mental Health	P-979
Nov 28	Review of the Fiscal and Operational Activities of the Antelope Valley Fair (Letter Report)	C-957
Dec 12	Los Angeles County Needs To Improve Its Services to Foster Children and the State Needs To Improve Its Oversight of the County's Foster Care Program	P-927
Dec 19	A Review of Adherence to Standards of Fair Employment by 25 United States Firms With Business Operations in Northern Ireland (Letter Report)	P-040
Dec 19	City of Imperial Beach User Fee Study	C-018
Dec 20	A Review of Tax Increment Revenues Provided to School and Community College Districts From Redevelopment Project Areas	P-023
Dec 21	The Department of Parks and Recreation Can Improve Aspects of the California Off-Highway Motor Vehicle Recreation Program	P-776

<u>Date of Issue</u>	<u>Report Title</u>	<u>Report No.</u>
<u>1991</u>		
Jan 30	State of California, Financial Report, Year Ended June 30, 1990	F-001
Jan 30	Some School Construction Funds Are Improperly Used and Not Maximized	P-013
Jan 31	A Review of the Factors That Contributed To the Closure of the First Independent Trust Company (Letter Report)	F-041
Jan 31	The Department of Health Services' Information on Drug Treatment Authorization Requests (Letter Report)	P-044
Feb 06	A Review of Los Angeles County's Implementation of the Greater Avenues for Independence Program	P-919
Feb 21	The Department of Conservation Needs To Make Some Improvements in the Beverage Container Recycling Program	P-966
Feb 27	The Department of General Services Needs To Improve Its Management of the Design and Construction of State Buildings	P-017
Feb 28	State of California, Statement of Securities Accountability of the State Treasurer's Office, June 30, 1990	F-004
Mar 13	A Review of Some Administrative Functions of the California State University	F-050
Mar 20	A Review of the California State Summer School for the Arts (Letter Report)	P-052

<u>Date of Issue</u>	<u>Report Title</u>	<u>Report No.</u>
Mar 21	A Review of the California Horse Racing Board's Contracting for Equine Drug Testing and Its Personnel Practices	P-945
Mar 28	A Review of the State's Controls Over Its Financial Operations	F-005
Mar 29	State of California Comprehensive Financial and Compliance Audit Report, Year Ended June 30, 1990	F-006
Apr 03	A Review of the Department of Corrections' Implementation of Its Substance Abuse Treatment and Education Services (Letter Report)	P-860
Apr 04	Federal and State Equity in EDD Owned Buildings (Letter Report)	F-051
Apr 11	The California Exposition and State Fair's Financial Status for the Fiscal Year Ended June 30, 1990 (Letter Report)	F-025
Apr 17	The Martin Luther King Jr. Family Health Center Needs To Improve Its Financial Operations	P-021
Apr 18	A Review of the Processing of Complaints Made to the Medical Board of California	P-049
Apr 19	Public Reports of Investigation Completed by the Office of the Auditor General From August 1, 1989 Through December 31, 1990	I-116
May 03	Cost Effectiveness of the Medi-Cal Therapeutic Drug Utilization Review Program	C-775

<u>Date of Issue</u>	<u>Report Title</u>	<u>Report No.</u>
May 08	A Review of the Seven Developmental Centers Operated by the Department of Developmental Services	P-961
May 15	Portable Classrooms in California School Districts: Their Safety, Uses, Cost, and the Time It Takes To Acquire Them	P-977
May 16	Some Animal Control Agencies Need To Improve Their Management for Funds Available for Dog and Cat Population Control (Letter Report)	P-035
May 17	The Potential Benefits of Further Centralizing the Functions of State Entities That Regulate Professions Appear Limited	P-022
May 23	Status of Franchise Tax Board/Board of Equalization Tax Settlements (Letter Report)	F-031
Jun 05	A Review of the Management Practices and Financial Operations of the Riverside Community College District	F-019
Jun 19	A Review of the Department of Health Services' Estimates of Savings Resulting From the Medi-Cal Drug Discount Program (Letter Report)	P-113
Jun 20	A Study of the Health Care Cost Escalation in California	C-057
Jul 03	A Review Concerning Allegations of Conflict of Interest By a Board Member of the Bay Area Rapid Transit District (Letter Report)	P-036
Jul 17	A Review of the Department of Alcohol and Drug Programs' Drug/Medi-Cal Claims Process	P-965

<u>Date of Issue</u>	<u>Report Title</u>	<u>Report No.</u>
Jul 24	The Department of Health Services' Information on Drug Treatment Authorization Requests (Letter Report)	P-117
Jul 25	The Office of State Printing Needs To Strengthen Controls Over Its Data Processing Resources	T-973
Jul 31	The California Housing Finance Agency Has Generally Complied With Statutory Requirements in Financing Single-Family Homes and Multifamily Rental Projects	P-950
Aug 01	The Lake Elsinore Management Project (Letter Report)	P-042
Aug 07	A Review of the Division of Labor Standards Enforcement's Handling of the <i>Crowe vs. Simpson</i> Attorney Fees Dispute (Letter Report)	P-033
Aug 14	California's Efforts To Meet Participation Goals for Minorities' and Women's Businesses in State Contracts	P-131
Aug 15	A Review of the Board of Equalization's Travel Claims (Letter Report)	P-026
Aug 21	An Analysis of Sanctions in the General Relief/General Assistance Programs of Six Counties	P-009
Aug 28	A Review of the Inglewood Unified School District's Management Practices and Student Academic Records	F-028
Aug 29	Some Institutions Within the California Department of Corrections Need To Improve Their Disability Payroll Procedures	F-059

<u>Date of Issue</u>	<u>Report Title</u>	<u>Report No.</u>
Aug 30	How Medi-Cal and Other Health Care Providers Manage Their Pharmaceutical Expenditures	P-062
Sep 05	The State Athletic Commission Needs To Improve Its Controls Over the Professional Boxers' Pension Plan	P-027
Oct 03	The Department of General Services' Administrative Oversight of State Agencies That Award Contracts (Letter Report)	P-014
Oct 18	A Review of the Department of Corrections' Implementation of Its Substance Abuse Treatment and Education Services (Letter Report)	P-122
Oct 23	Status of Costs Identified and Reimbursed for the State Legalization Impact Assistance Grants	F-132
Oct 30	The Department of Toxic Substances Control Has Not Taken Sufficient Action To Bill and Recover Hazardous Waste Cleanup Costs From Responsible Parties (Letter Report)	F-426.1
Nov 27	A Review of the California State University's Disabled Student Services	P-054
Dec 19	A Review of the Usefulness of Domestic Disclosure Spreadsheets to the Franchise Tax Board (Letter Report)	F-864

DEPARTMENT OF FINANCE

915 L STREET
SACRAMENTO, CA 95814-4998



June 4, 1992

Kurt R. Sjoberg
Acting Auditor General
660 J Street, Suite 300
Sacramento, CA 95814

Dear Mr. Sjoberg:

REPORT F-105--A REVIEW OF THE STATE'S CONTROLS OVER ITS FINANCIAL OPERATIONS

I appreciate the opportunity to respond to the draft copy of the subject report which was prepared in conjunction with your examination of the State's general purpose financial statements for the Fiscal Year ended June 30, 1991. This draft contains your findings resulting from your study and evaluation of internal controls and your report on the State's compliance with Federal grant requirements. These findings will be incorporated into the Single Audit report filed by the State of California covering Fiscal Year 1990-91. I am pleased to note that four of the findings reported in the prior year, including the accountability of fixed assets, have been corrected and are not included in the current report. I am also pleased to note that no new statewide issues have arisen during the past year.

The State of California is a very large and diverse entity with numerous programs and activities being carried out for its citizens. It is now facing unprecedented budget constraints that will test its ability to carry out those programs and make decisions regarding benefit and costs of controls even more difficult. Regardless, the control of the State's financial operations is important and it continues to be the responsibility of all of us to work toward assuring that the assets under its control are properly guarded and the operations of its various units are carried out in the most cost efficient manner. While we know much remains to be done to effect improvements, the fact that the cumulative findings do not adversely affect the State's general purpose statements is evidence that the operation is generally working.

We appreciate the concerns expressed in the identification of actual and potential losses. Each department where you have identified internal control weaknesses is responsible for responding as to what corrective actions they will take. Our response to each of the statewide concerns that you've identified in your draft follows.

INCONSISTENT FINANCIAL REPORTING

We are continuing to address the issue of Generally Accepted Accounting Principles (GAAP) in several areas, including budget preparation and State agency reporting. As you're aware, in the past two years, we've made changes to account for some major revenues and expenditures in a manner more consistent with GAAP. However, because of the complexity of the State's budgeting and reporting system we have to move cautiously in making any future changes.

PROBLEMS WITH THE STATE'S CONVERSION TO GAAP

The State of California continues in its efforts to convert to GAAP where it is in the best interest of the State. However, as stated in our responses in prior fiscal years, there are some areas of GAAP where the proper accounting treatment is impractical and costly. For example, accounting for vacation accruals requires the establishment of very expensive record systems which do not aid in the effective administration of the State. Consequently, we are proceeding cautiously in this area as well.

Currently, state agencies are required to report in accordance with legal requirements. The State Controller converts this data to GAAP to issue the year-end financial statements. We are not aware of difficulties encountered by the State Controller in meeting this conversion.

SOME INTERNAL SERVICE FUNDS DO NOT ALWAYS COMPLY WITH FEDERAL REGULATIONS

We are concerned that the State comply with all federal regulations. The administrative processes used by the State's Internal Service Funds are intended to meet the State's needs and comply with State laws and regulations. In some cases, such laws and regulations differ from those of the federal government. Federal requirements need to be changed to allow the maintenance of reasonable working capital reserves. When those requirements are changed, the State will issue appropriate guidelines for the Internal Service Funds.

DELAYS IN PRODUCING AUDITED FINANCIAL STATEMENTS

The State is continuing in its efforts to reduce the time required by the several State agencies to prepare and submit the year-end statements to the State Controller's Office for incorporation into the annual report. Virtually all State agencies are now submitting correct statements no later than the first of September. As a result of a prior pilot project, statewide automation is planned to replace a number of standard reports.

LACK OF COMBINING STATEMENTS BY FUND TYPE

The State Controller's Office has taken the lead role in the process of determining the steps necessary to prepare a comprehensive annual report in accordance with GAAP. The State Controller is currently issuing both an annual report in accordance with the State's legal basis of accounting and an annual report containing general purpose financial statements in accordance with Chapter 1286, Statutes of 1984 (AB 3372).

INELIGIBILITY FOR CERTIFICATE OF ACHIEVEMENT

As we have previously stated, we and the State Controller's Office recognize the desirability of qualifying California for the Certificate of Achievement for Excellence in Financial Reporting. As we've reported before, there are committees to work towards overcoming the three major areas of concern that preclude us from qualifying for this award. One such major issue was the concern about the fixed assets accountability and has now been resolved. We will be working on the other two areas of concern. Our responses to these areas are contained in various sections of this letter.

INSUFFICIENT REPORTING OF LEASING INFORMATION

The development of a central record of all lease commitments by the State is an enormously difficult task. The Department of General Services is now the central depository for the bulk of the leasing information but, at this time, does not have access to lease for the University of California or the Department of Transportation. We will continue in our efforts to examine what must be done to complete this task.

INADEQUATE CONTROL OVER SOME CONTRACTS

As you indicate in your report, there is some legal basis for not requiring the Department of General Services to process all contracts. The Department of General Services believes that legislation is needed to have the department act as a clearinghouse for all contracts, grants and interagency agreements.

FAILURE TO REQUIRE ACCOUNTING FOR EXPENDITURES OF FEDERAL MONEYS BY EACH FEDERAL PROGRAM

We agree that the accounting system presently used to record federal moneys needs to be changed to one that will meet all federal and State requirements, and will be addressing it as other priorities and resources allow.

Mr. Kurt R. Sjoberg
Page Four

IMPROPER OMISSIONS FROM THE STATE REPORTING PROCESS

The State Controller's Office and the Department of Food and Agriculture are reviewing this issue to determine the feasibility of including the District Agriculture Fairs into the State reporting entity. However, it may require legislation to set up the reporting structure.

FAILURE TO REQUIRE AGENCIES TO SUBMIT RECONCILIATIONS TO THE STATE CONTROLLER'S OFFICE AND FAILURE TO REQUIRE AGENCIES TO PREPARE A REPORT OF ACCRUALS

The Department of Finance is reviewing the proposed requirements for State agencies to complete a full set of year-end reports for non Government Code Funds (including the Report of Accruals and the Reconciliation of Agency Accounts with transaction per State Controller). State agencies have been surveyed to identify the associated workload, procedures, and other issues. The surveys have been received and the data is being analyzed for possible effect on the reporting process. We will be addressing this issue as other priorities permit.

We are aware that in many areas efforts are already underway to correct and strengthen weaknesses disclosed by both your audit effort and those of our own internal control reviews. We wish to continue to show progress in our efforts to improve the controls over the State's financial operations at the statewide levels as well as at individual departments. It will take the combined efforts of all of us to achieve this goal.

Sincerely,


THOMAS W. HAYES
Director of Finance

cc: Curt I. Davis, CPA
Deputy Auditor General

cc: **Members of the Legislature**
Office of the Governor
Office of the Lieutenant Governor
State Controller
Legislative Analyst
Assembly Office of Research
Senate Office of Research
Assembly Majority/Minority Consultants
Senate Majority/Minority Consultants
Capitol Press Corps